

SECURITIES MARKET IN JAPAN

2018

JAPAN SECURITIES RESEARCH INSTITUTE

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into English. It includes quotations from or references to descriptions of laws and
regulations such as the Financial Instruments and Exchange Act; however, it is the laws and
regulations in Japanese themselves that have legal effect and the translations given herein
are only for your reference. For legal matters, see the laws and regulations
in Japanese described in the official journal.*

PREFACE

The advancement of information technology is having a significant impact on the world economy in terms of growth and structural changes. Particularly in financial and securities sectors, it has been pointed out that the introduction of FinTech and new FinTech-based services and technologies, such as robo-adviser, crowdfunding, and block chain, will bring about rapid and material reforms to how business segment regulations and markets ought to be. At the present moment, however, it is difficult to accurately forecast what specific moves will take place going forward.

Meanwhile, the recent world economy has been relatively favorable with the term “Goldilocks Economy” being applied, despite facing various risks. Yet there are times when markets fluctuate significantly due to political and economical factors, and by no means can we say that the recent economic conditions allow us to ignore the concern of risks becoming apparent.

Japan Securities Research Institute has issued an updated edition of *The Securities Market in Japan: An Illustrated Guide* every two years since 1973. The book is intended to explain the structures, functions and current status of Japan’s securities markets in a simple, user-friendly manner as much as possible. Following the previous 2016 edition, this is the English version of the 2018 edition of *The Securities Market in Japan*. In this updated edition, we included new sections on FinTech and the corporate governance code. We also added descriptions on new moves on the market, including the introduction of the Japanese-version Fair Disclosure Rules, in an effort to provide timely contents.

Moreover, at Japan Securities Research Institute, we work to deepen our understanding of the latest status of securities markets in other countries, including developments toward financial and securities systems reforms. As part of this effort, we also issue other illustrated guides, such as “*The Securities Market in the U.S.*,” “*The European Securities Markets*” and “*The Asian Securities Markets*,” every few years. We do this with a view to providing easy-to-understand explanations of securities markets of leading countries in Europe, the U.S. and Asia. We hope that the series of these books will also be of use to those who are interested.

As with our previous publications, this book was compiled by a group of

specialists, including researchers and research fellows at Japan Securities Research Institute and experts at the Japan Securities Dealers Association (JSDA), the Japan Exchange Group (JPX), Japan Securities Finance (JSF) and Japan Investment Advisers Association, who took part in writing the sections assigned to them respectively. The assignment of writing tasks is as shown on the next page. Researchers Kazuya Takahashi and Kazutoshi Tashiro at Japan Securities Research Institute were responsible for the overall compilation.

As previously mentioned, under circumstances in which it is difficult to accurately envision the future, we find it extremely important to take another comprehensive view of and accurately understand the history and current status of Japan's securities market on the whole. We sincerely hope that this book will be of wide use to not only persons related to the securities industry but also many of those who have an interest in this theme.

March 2018

KIICHIROU MASUI

President

Japan Securities Research Institute

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CHAPTER I

The Securities Market and the National Economy

1. What Is a Security?

The financial markets provide a marketplace through which funds are channeled from sectors with idle cash (lenders) to cash-short sectors (borrowers), and the types of financing arranged on these markets are divided in terms of intermediaries into indirect and direct financing. Indirect financing means a form of transaction in which a financial institution acquires a primary security (due bills and notes, etc.) from a borrower with a fund raised by issuing an indirect security (certificates of deposit and insurance policies, etc.). In direct financing, a borrower raises funds by issuing a primary security (equity and debt securities, etc.) to lenders through a market intermediary. The marketplace on which direct financing is arranged is the securities market, and it is divided into a primary market (where securities are issued and distributed) and a secondary market (where securities are bought and sold).

Generally, the term “security” refers to instruments that give their legal holders the rights to money or other property. They are designed to facilitate the assignment of such rights and have the characteristic of combining rights and certificates. More specifically, securities are issued in various forms, such as stocks and bonds issued by business corporations; notes, checks, and bills of lading; government securities issued by national governments; and municipal bonds issued by local public bodies. Of these, securities traded in the securities markets are called “securities under the Financial Instruments and Exchange Act (FIEA),” as defined in Paragraphs 1 and 2, Article 2 of that law. Paragraph 1 defines securities whose interests are represented by securities or certificates that are physically issued as listed in the table on the right. In addition to those provided for in the former Securities and Exchange Act, new types of securities, such as mortgage securities and securities representing financial options contracts, have been included. Item (xxi) of the paragraph provides that securities or certificates designated by government ordinance include bonds issued by educational institutions, etc.

Paragraph 2 of Article 2 sets forth the definition of deemed securities. First, interests represented by securities that are listed in the preceding para-

Table I-1. The Definition of Securities under the Provisions of Paragraphs 2-1 and 2-2 of FIEA

Paragraph 2-1 Securities

1. Government securities
2. Municipal bond securities
3. Bonds issued by special public corporations
4. Specified corporate bonds as provided for in the Act on the Liquidation of Assets
5. Corporate bonds
6. Subscription certificates issued by special public corporations
7. Preferred shares as provided for in the Law Concerning Preferred Shares in Cooperative Financial Institutions
8. Preferred subscription certificates or new preferred subscription rights certificates as provided for in the Act on the Liquidation of Assets
9. Stock certificates or subscription right/warrant certificates
10. Beneficiary certificates of investment trusts or foreign investment trusts
11. Investment certificates or bonds issued by investment corporations, investment equity subscription rights certificates or investment certificates issued by foreign investment corporations
12. Beneficiary certificates of loan trusts
13. Beneficiary certificates of special-purpose trusts as provided for in the Act on the Liquidation of Assets
14. Beneficiary certificates of certificate-issuing trusts as provided for in the Trust Law
15. Commercial paper
16. Mortgage securities
17. Foreign securities: foreign certificates that have the attributes of any type of securities as defined in Items 1 through 9 and Items 12 through 16 hereof
18. Beneficiary certificates of foreign loan claims trusts
19. (Financial) options securities or certificates
20. Foreign depository securities or receipts
21. Securities or certificates designated by government ordinance

Paragraph 2-2 Deemed Securities

(General description of the former clause)

Interests represented by securities that are listed in the preceding paragraph in cases where no physical certificates are issued

(Latter clause)

1. Beneficiary interests in trusts
2. Beneficiary interests in foreign trusts
3. Partnership interests in general or limited partnership companies (*gomei gaisha* or *goshi gaisha*), as designated by government ordinance, or interests in limited liabilities companies (*godo gaisha*)
4. Partnership interests in foreign corporations, with the attributes of interests defined in any of the preceding items
5. Interests in collective investment schemes as comprehensively defined
6. Interests in foreign collective investment schemes
7. Other interests as designated by government ordinance

Source: Based on Toshiro Ueyanagi, Yutaka Ishitoya, and Takeo Sakurai, *Shin Kin'yu Shohin Torihiki-ho Handobukku*, Nippon Hyoronsha, 2006, and Etsuro Kuronuma, *Kin'yu Shohin Torihiki-ho Nyumon*, Nihon Keizai Shimbun, 2006, and the Financial Instruments and Exchange Act as listed in e-Gov's legal data service.

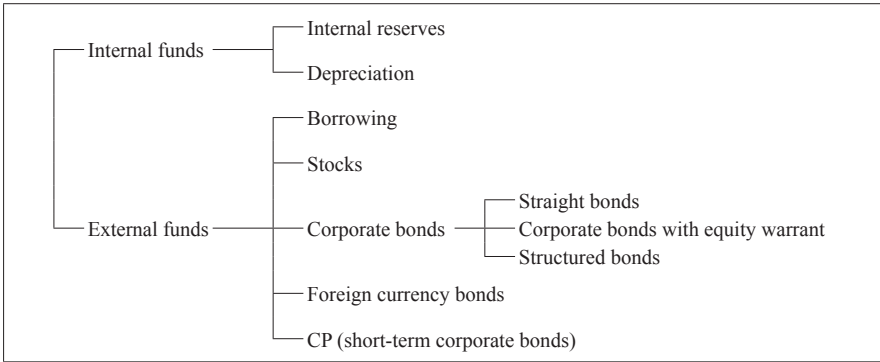
graph are deemed to be securities by themselves in cases where no physical certificates are issued. For example, interests represented by bonds or stocks held under a book-entry transfer system are deemed to be equivalent to those securities listed in Paragraph 1. The latter part of the paragraph then goes on to define deemed securities as interests other than those represented by securities or certificates. The scope of the definition has been substantially widened compared with that of the former law, and, specifically, there are comprehensive provisions in Item (v) of the paragraph for the FIEA to be applicable to various types of collective investment vehicles, or funds. In Item (vii), interests designated by government ordinance, including claims on loans to educational institutions, are provided for as deemed securities. In addition to securities, the FIEA applies to derivatives trading in domestic financial instruments exchanges, over-the-counter markets and foreign markets.

2. Corporate Financing

The term “business corporation” (excluding financial service institutions) means economic entities whose objective is to make a profit from such activities as the production and sale of goods or services. Business corporations invest funds in real assets (such as facilities and products in inventories) to carry out production and marketing activities on a continuing basis.

Funds raised by business corporations are divided into internal funds (those generated in the ordinary course of the production and sale of goods or services) and external funds (those raised from external sources), according to the method employed to raise them. Technically, internal reserves and depreciation charges are included in internal funds. As corporations are not required to repay the principal of, or pay interest or dividends on, such funds, they are considered the most stable means of corporate financing. In actuality, however, business corporations cannot meet their funding requirements with internal funds alone, and many of them have to rely on external funds. External funds are divided into the proceeds resulting from loans and the issuance of equity and corporate bond, according to the method employed to raise them. Loans are obtained primarily from banking institutions. This method of raising funds with debt securities is termed “indirect financing.” In addition to those issued at the time of their incorporation, business corporations issue additional equity shares (an increase of capital) to finance the expansion of their production capacity or for other purposes. As business corporations are not required to repay the principal thus raised, or pay interest thereon, the proceeds from the issuance of equity shares constitute the most stable form of funds among external funds. As is the case with equity shares, corporate bonds are also an instrument for raising funds from the capital mar-

Chart I-1. Corporate Financing



Note: Internal reserves refer to a company's after-tax income less any dividends and officers' bonuses. Depreciation charges are recognized as the economic benefits of tangible fixed assets, such as buildings and machinery, that are consumed each year and recorded as expenses. In other words, they are reserves for facility replacement.

kets, and issuers have to redeem them on or by a predetermined date of redemption and pay a definite rate of interest on them. Corporate bonds are largely divided into straight bonds (SB), corporate bonds with subscription rights/warrants, and structured bonds (see Chapter V regarding corporate bonds with subscription rights/warrants and structured bonds). The issuance of equity shares or corporate bonds is recognized as a means of raising funds by the “direct financing” method.

A survey of changes that have occurred in the amount of funds raised by companies from external sources as a percentage of the outstanding balance of financial debts shows that bank borrowings have tended to decrease since the 1980s. This tendency was triggered by the fact that following the liberalization and internationalization of the financial markets, businesses have actively sought to raise funds by selling new shares and corporate bonds on the market. Since the 2000s, funds raised through the issue of securities have outpaced those obtained through bank borrowings, and the weight of corporate financing structure has shifted from indirect to direct financing. Although at one point the proportion of loan financing rose after the financial crisis of 2008 curtailed the functioning of the capital market, financing through the issue of securities, primarily stocks, has come to account for the majority after the hike in stock prices at the end of 2012. In addition, the total amount of financing has been increasing over the last few years. Considering that the enhancement of emerging markets and deregulation and abolition of various bond regulations have led to establishing the approach of raising funds on the capital market for not only large companies but also small and midsize com-

Table I-2. Percentage of Funds Raised and Invested by the Corporate Sector

(balances at fiscal year-end)

	1980	1985	1990	1995	2000	2005	2010	2016
Management								
Cash and demand deposits	10.0	7.6	6.6	9.1	13.3	15.5	18.4	14.8
Time deposits	14.5	14.8	12.8	10.8	7.7	4.1	6.3	6.0
CDs	0.1	1.2	1.1	2.6	3.3	1.5	1.8	1.5
Trusts	1.3	1.4	0.7	1.3	0.3	0.3	0.3	0.4
Investment trusts	0.1	0.6	0.2	0.4	1.0	0.7	1.8	1.2
Securities	15.7	25.9	30.9	24.2	22.9	36.4	19.4	32.3
(equity shares)	13.5	23.5	28.1	22.6	19.6	33.4	16.3	30.3
(debt securities)	2.2	2.3	2.8	1.6	3.3	3.0	3.1	2.0
Inter-business credits	45.5	35.2	30.5	35.3	33.5	24.4	27.1	19.4
Others	12.7	13.2	17.2	16.3	18.2	17.1	24.9	24.4
Total	312.4	483.5	835.7	783.2	738.9	950.3	792.6	1,146.1
Financing								
Borrowing	42.2	39.5	36.5	40.2	36.2	22.4	31.3	24.4
Securities	27.1	38.1	43.1	38.6	42.0	58.2	42.5	54.8
(equity shares)	23.1	33.9	37.3	32.7	35.2	52.9	35.2	50.0
(corporate bonds)	2.2	2.6	2.3	3.8	5.3	4.1	5.8	3.6
(foreign currency bonds)	1.8	1.6	2.6	1.5	0.6	0.8	0.8	1.1
(CPs)	—	—	0.8	0.6	0.9	0.4	0.7	0.1
Inter-business credits	24.3	17.0	14.6	15.4	16.2	12.8	15.4	11.9
Others	6.4	5.5	5.8	5.8	5.6	6.6	10.8	8.9
Total	477.4	760.6	1,358.7	1,351.7	1,198.0	1,421.8	1,056.7	1,658.8

Notes: 1. In percentages and trillions of yen.

2. Time and savings deposits include foreign currency deposits.

3. Figures in parentheses are a breakdown of securities, and equity shares include equity subscriptions.

4. Investment of equity shares is based on market prices and that of new shares issued in the years up to fiscal 1990, inclusive, is based on the capital plus capital reserve and that is based on the market prices since fiscal 1995.

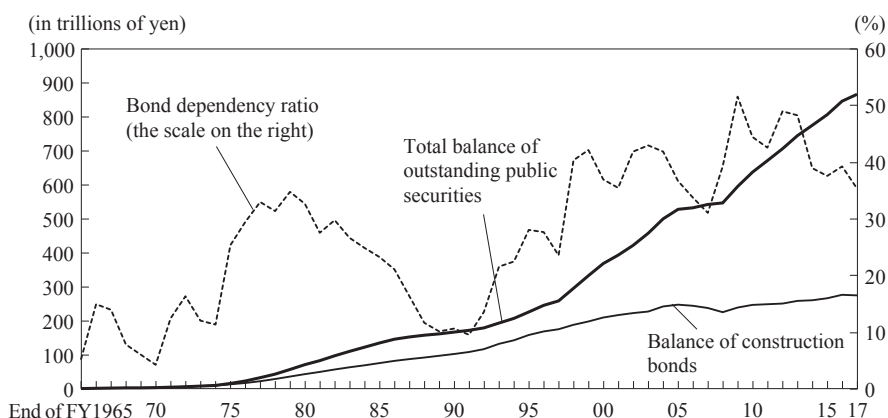
Source: Compiled from the Flow of Funds Account data published on the web site of the Bank of Japan.

panies, the predominance of raising funds through the issue of securities is expected to remain stably also going forward.

3. The Securities Market and Public Finance

Public finance is a type of economic activity carried out by the government (national and local). More specifically, it is a government activity undertaken to finance administrative services (law enforcement and education, etc.) and

Chart I-2. Changes in the Balance of Outstanding Public Securities and the Degree of Dependence on Public Securities



Notes: 1. Figures prior to fiscal 2013 are actual results. Figures for fiscal 2014 are based on revised budget and those for fiscal 2016 and fiscal 2017 are estimates.

2. Based on straight government bonds.

Source: Compiled from the data issued by the Ministry of Finance.

public investment with taxes and other revenues. In practice, the government adjusts its fiscal policies in response to economic trends. When government expenditures exceed revenues, the deficit is met mainly by issuing public bonds (government and municipal government bonds).

A survey of changes that have occurred in the balance of outstanding public bonds and the government's dependency on debt financing shows that the government had issued special government bonds (deficit-financing) in fiscal 1965, the first time since the end of World War II, under a supplementary budget and also that the government has issued a series of construction bonds on a continuing basis since fiscal 1966. However, both the bond dependency ratio and the balance of outstanding government debt securities had remained at a low level until the first half of the 1970s. As tax revenues had leveled off due to an economic slowdown that began in the second half of the 1970s, the government had no choice but to issue a large amount of government bonds, and their outstanding balance had increased sharply to ¥71 trillion at the end of fiscal 1980. As a result, government bonds came to carry an increasing weight in the securities market, and the influence of government fiscal policies on the securities market had taken on a growing importance. With a view to improving the market's financial condition, the government has adopted a fiscal restructuring policy since fiscal 1981. Helped by economic recovery, the government succeeded in lowering the dependency on deficit financing

Table I-3. Changes in JGB and Short-Term Government Bill Ownership by Investor Type

(in percentages)

Types of investors	FY2005	FY2007	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	End of Dec. 2016
General government	3.5	3.4	1.6	2.9	1.6	1.6	2.0	1.9	0.2	0.2
Public pension funds	8.1	9.8	9.2	8.3	7.5	7.1	6.7	5.4	4.9	4.6
Fiscal loan funds	8.0	2.5	0.2	0.1	0.1	0.5	0.1	0.3	0.0	0.0
Bank of Japan	12.2	8.5	8.9	9.0	9.7	13.2	20.2	26.5	33.9	39.1
Banks	40.8	43.0	47.4	46.2	45.8	42.4	36.4	31.4	25.6	21.3
Postal savings funds/ Japan Post Bank	17.2	19.5	18.8	16.7	15.8	14.3	12.7	10.3	7.7	6.8
Life, nonlife, and other insurance companies	15.6	16.6	18.5	18.4	19.2	19.9	19.5	19.2	19.7	19.3
Postal insurance/ Japan Post Insurance	7.9	8.6	8.1	7.3	6.5	5.8	5.3	4.6	4.1	4.0
Pension funds	3.1	3.4	3.4	3.2	3.2	3.4	3.5	3.3	3.2	2.9
Overseas	4.4	7.4	5.6	7.1	8.3	8.5	8.2	9.4	10.2	10.5
Households	3.7	4.5	4.1	3.6	3.0	2.5	2.1	1.6	1.3	1.2
Others	0.8	0.8	1.2	1.4	1.6	1.1	1.4	1.0	0.9	0.9

Notes: 1. Figures for the end of fiscal 2016 are preliminary figures.

2. Banks include securities investment trusts and securities companies.

3. Others are composed of nonfinancial corporations and private nonprofit institutions serving households.

4. Previous to fiscal 2007, figures included short-term discount bills (TB) and financing bills (FB), while treasury bills (T-Bill) have been included since fiscal 2008. As of February 2009, TB and FB were integrated into T-Bills.

5. Figures are based on a retroactive revision made on June 29, 2015.

Source: Compiled from Saimu kanri ripoto 2015 (Debt Management Report 2015) published by the Ministry of Finance and the Flow of Funds Account data published on the web site of the Bank of Japan.

and in curbing increases in the balance of outstanding public bonds in the second half of the 1980s. After the 1990s, however, the dependency on deficit financing rose sharply due to a contraction of tax revenues caused by a prolonged recession and the implementation of a series of economic stimulus packages. After exceeding 50% in 2009, the public bond dependency ratio has been on a moderate decline. Meanwhile, the balance of outstanding public securities is expected to continue increasing and reach approximately ¥865 trillion at the end of fiscal 2017.

Looking at the ownership structure of Japanese government bonds (JGB)

as shown in Table I-3, the ownership of private financial institutions, including Japan Post Bank and Japan Post Insurance, has been declining since fiscal 2012. This change is primarily due to the bold quantitative and qualitative monetary easing measures introduced by the Bank of Japan in April 2013. Meanwhile, the Bank of Japan considerably increased its percentage of ownership and has become the highest investor, surpassing the banks. Public pension funds that used to be stable investors premising their investments on long-term ownership are lowering their percentage of investment in domestic bonds given that the Government Pension Investment Fund (GPIF) made a major change to its distribution of investment assets in October 2014. As a result, the percentage held by public pension funds dropped as low as 4.6% at the end of 2016. The ownership of overseas investors has been on a gradual increase after a period of growth in demand for JGBs as safe assets in light of the sovereign debt crisis in Europe that occurred in 2010 and the percentage reached 10.5% at the end of 2016. On the contrary, the percentage ownership of Japanese households started to fall after fiscal 2008.

4. Financial Assets Held by the Household Sector

The household sector of Japan has consistently run a surplus (over-saving). Although the ratio of nominal household surpluses to the nominal gross domestic product (GDP) dropped to about 4% in fiscal 2016 after hitting a peak in the mid-1990s, pro-longed over-saving coupled with a rise in stock prices has brought about a huge accumulation of households' financial assets, standing at approximately ¥1,830 trillion as of the end of June 2017.

A survey of changes that have occurred in the management of financial assets of the household sector found the following three characteristics. First, while the component ratio of cash and demand deposits has been rising, time deposits, which used to carry the largest weight within financial assets, has tended to decrease since the 1980s. This tendency of the component ratio is mainly due to the low interest rate policy and the quantitative and qualitative monetary easing measures adopted by the Bank of Japan. Second, the ratios of insurance and annuities rose almost consistently through to the end of fiscal 2000 and have since remained stable. This trend likely reflects that Japan has already become an aging society. Third, the weight of securities in household financial assets, particularly for stocks, has been declining considerably the financial crisis to the rapid slump in stock prices following the sluggish stock market since the bursting of the Japanese economic bubble in the 1990s and the Lehman Shock (term used in Japan for the global financial crisis) in 2008. However, the weight of securities recovered on the back of a recovery of the stock market after the end of 2012 and reached 11.1% at the end of fis-

Table I-4. Percentage Composition of Financial Assets of Individuals

	(at fiscal year-end)							
	1980	1985	1990	1995	2000	2005	2010	2016
Cash and demand deposits	9.8	7.7	7.2	8.2	11.6	21.0	23.6	26.2
Time deposits	48.7	44.9	40.2	41.9	42.5	29.7	31.6	25.4
Trusts	4.5	4.0	3.7	3.4	1.5	0.4	0.2	0.2
Insurance funds	13.4	16.3	20.8	25.4	27.2	25.8	28.4	28.7
Investment trusts	1.2	2.3	3.4	2.3	2.4	3.4	3.6	5.4
Securities	16.1	19.7	19.6	13.9	9.7	15.3	8.6	11.1
(equity shares)	13.2	16.0	16.9	11.5	7.7	13.0	6.2	10.1
(debt securities)	2.8	3.7	2.6	2.5	2.0	2.3	2.4	1.0
Others	6.3	5.2	5.2	4.9	5.1	4.4	4.1	3.0
Total amount	372.0	626.8	1,017.5	1,256.5	1,388.8	1,516.6	1,480.6	1,808.0

Notes: 1. Composition in percentages and totals in trillions of yen.

2. Time and savings deposits include negotiable and foreign-currency deposits.

3. Figures in parentheses are a breakdown of securities, and equity shares include equity subscriptions.

4. Equity shares are based on market prices.

Source: Compiled from the Flow of Funds Accounts data published on the web site of the Bank of Japan.

Table I-5. Comparison of Japanese and U.S. Household Assets Composition (as of March 31, 2017)

	Japan	United States
Cash and demand deposits	51.5%	13.4%
Bonds	1.4%	5.6%
Investment Trusts	5.4%	11.0%
Securities and equity subscriptions	10.0%	35.8%
Insurance funds	28.8%	31.2%
Others	2.9%	2.9%

Note: U.S. household assets include non-profit making institutions providing services to households.

Source: Compiled from the Bank of Japan's "Comparison of the flow of funds between Japan and the United States" (August 18, 2017).

cal 2016.

A comparison of household investment in financial assets between Japan and the United States (including, in the case of the latter, those of nonprofit-making institutions providing services to households) as of the end of March 2017 still shows a large difference in the preference of investors for types of assets. While Japanese households invest 80.3% of their funds in cash deposits, insurance funds, and pension funds and 16.8% of their funds in securities (including investment trusts), their American counterparts invest 44.6% of their funds in the former and 52.4% in the latter. While it is necessary to take the social security systems, retail loan services, and other differences between the two countries into account, these figures suggest that while Japanese households prefer assets that guarantee principal, their American counterparts choose investment performance.

However, the defined contribution pension plan introduced in 2001 and the Nippon Individual Saving Account (NISA), a small-amount investment tax exemption scheme, launched in January 2014 have been steadily gaining popularity. In addition, the individual-type defined-contribution pension plan (iDeCo) was revised in January 2017 to widen its eligibility, and an installment-type NISA plan will be launched in January 2018. Hence, a stronger direct link has been forged between households and the securities market. Furthermore, a broader range of investment trusts and exchange traded funds (ETF) among other factors are increasing the options for household investment in financial assets. Going forward, this sector will call for an improvement in the quality of retail sales operations and greater dissemination and understanding of financial knowledge among Japanese households.

5. Investment Behavior of Foreigners (Inbound Securities Investment)

Over a period of years after the war, international financial and capital transactions were banned, in principle. However, since the Foreign Exchange and Foreign Trade Act was amended in December 1980 (the new Foreign Exchange and Foreign Trade Act), the system of licensing international financial and capital transactions was changed to a prior reporting system, making them free in principle. Furthermore, by virtue of an amendment to the new Foreign Exchange and Foreign Trade Act in April 1998 (one the main reforms under what was locally called “the Japanese version of the Big Bang”), the prior reporting system of currency transactions was abolished, completely liberalizing direct financial transactions with overseas customers.

A survey of inbound investments in securities made by foreign investors in recent years shows that they have consistently net bought Japanese stocks except for sell-offs in the markets that occurred in 2000 and 2002 after the

Table I-6. Investment (on a settlement basis)

(¥100 million)

Calendar year	Equity Securities			Debt Securities (excluding bills)			Net balance
	Bought	Sold	Net	Bought	Sold	Net	
2000	835,593	837,932	- 2,339	571,013	470,246	100,767	98,429
2001	779,015	741,061	37,954	522,905	504,878	18,027	55,981
2002	644,372	657,039	- 12,667	582,775	618,928	- 36,153	- 48,819
2003	790,641	692,870	97,771	619,163	641,269	- 22,106	75,666
2004	1,161,630	1,056,357	105,273	727,773	683,161	44,612	149,885
2005	1,675,176	1,548,934	126,241	873,775	811,451	62,324	188,565
2006	2,671,452	2,590,472	80,981	1,035,501	970,532	64,969	145,950
2007	3,371,648	3,330,228	41,419	1,123,120	1,023,179	99,941	141,360
2008	2,640,366	2,714,152	- 73,786	895,747	933,021	- 37,274	- 111,060
2009	1,453,977	1,453,694	283	504,203	574,104	- 69,900	- 69,617
2010	1,736,099	1,717,710	18,389	695,100	688,976	6,125	24,513
2011	1,974,084	1,971,556	2,528	884,363	838,985	45,379	47,906
2012	1,867,789	1,846,517	21,272	811,683	790,007	21,676	42,948
2013	3,942,020	3,783,603	158,416	838,677	873,965	- 35,288	123,128
2014	4,115,951	4,089,468	26,483	762,694	676,154	86,540	113,022
2015	5,231,108	5,228,502	2,606	802,426	727,168	75,258	77,865
2016	4,955,097	5,011,755	- 56,658	965,053	921,289	43,764	- 12,894

Note: Up to 2004, figures were compiled based on “Changes in In-and Out-Bound Securities Investment (on a settlement basis).” Since 2005 and thereon, figures have been compiled based on “International Transactions in Securities (based on reports from designated major investors).”

Source: Compiled from materials listed on the web site of the Ministry of Finance.

bursting of the dot-com bubble. However, foreign investors reversed direction in 2008 after the Lehman Shock, becoming net sellers. Furthermore, the volumes of stocks bought and sold by foreign investors have increased sharply since 1999, with the result that the difference between the two has fluctuated widely. Particularly since 2012, the trading of Japanese stocks by foreign investors has become increasingly active against the backdrop of surging prices on the stock market. It is apparent that foreign investors also have consistently net bought Japanese debt securities (both bonds and notes). There has been net selling of debt securities by foreign investors in some years, but these temporary reversals involved selling to cover arbitrage positions. This situation happened in 1999 after the abolition of securities transaction taxes, during the depreciation of the yen in 2002 and 2003 and during the financial

Table I-7. Balance of Inbound Investment and Related Indicators

Year-end	Stocks (¥b)		Bonds (¥b)		TOPIX	Interest rate (%)	¥/\$ (¥)
2000	63,222	(30.4)	32,981	(15.8)	1,283.67	1.640	114.90
2001	49,563	(24.7)	33,546	(16.7)	1,032.14	1.365	131.47
2002	40,757	(21.4)	27,799	(14.6)	843.29	0.900	119.37
2003	60,085	(28.2)	27,108	(12.7)	1,043.69	1.360	106.97
2004	77,393	(31.2)	33,846	(13.6)	1,149.63	1.435	103.78
2005	132,842	(40.8)	41,428	(12.7)	1,649.76	1.470	117.48
2006	149,277	(43.5)	49,579	(14.5)	1,681.07	1.675	118.92
2007	142,031	(39.4)	60,203	(16.7)	1,475.68	1.500	113.12
2008	68,625	(23.4)	50,650	(17.3)	859.24	1.165	90.28
2009	76,372	(26.6)	42,236	(14.7)	907.59	1.285	92.13
2010	80,537	(26.4)	42,877	(14.0)	898.80	1.110	81.51
2011	65,841	(20.7)	45,730	(14.4)	728.61	0.980	77.57
2012	83,556	(23.2)	49,504	(13.8)	859.80	0.795	86.32
2013	152,323	(32.3)	50,168	(10.6)	1,302.29	0.740	105.37
2014	169,144	(29.2)	64,592	(11.2)	1,407.51	0.320	119.8
2015	186,919	(30.7)	72,623	(11.9)	1,547.30	0.265	120.42
2016	181,530	(28.0)	83,001	(12.8)	1,518.61	0.040	117.11

Notes: 1. Bonds include only long-term debt securities.

2. Figures given in parentheses are component ratios (%) to the total debts to overseas lenders.

3. Interest rate signifies the yield on 10-year government bonds newly issued and distributed on the secondary market.

4. ¥/\$ represents the closing spot rates on the Tokyo market.

Source: Compiled based on the data released by the Ministry of Finance and the Bank of Japan.

turmoil in 2008 and 2009. Net selling was also evident in 2013 due to the quantitative and qualitative monetary easing measures introduced by the Bank of Japan among other factors, but the level of trading was high. As was the case with stocks, the bond transaction level has stepped up since 1999, with the result that the difference between purchases and sales has fluctuated substantially. This trend may be explained by active arbitrage trading by foreign hedge funds in addition to the expanded market for medium-term government notes (with a maturity of two to five years) and other infrastructural factors.

Looking at the trend in stocks (debt), although the balance turned upward again in 2003 due to a recovery in stock prices, increasing to approximately ¥149 trillion at the end of 2006, by 2010 it had dropped to about ¥81 trillion because of the Lehman Shock. Subsequently, with the recovery of the stock

Table I-8. Percentages of Japanese Stocks and Bonds Held by Investors of Different Regions

(in percentages)

Year-end	United States	Europe	Asia	Others
Equity securities				
2006	41.5	50.3	2.0	6.2
2007	44.2	45.1	3.1	7.6
2008	49.8	37.6	3.6	9.0
2009	53.9	36.5	1.7	7.9
2010	46.6	36.0	7.7	9.7
2011	46.0	35.5	8.9	9.6
2012	44.3	37.2	8.4	10.1
2013	45.7	37.9	5.8	10.6
2014	47.4	36.9	5.4	10.3
2015	49.1	36.0	5.7	9.2
2016	49.9	34.9	6.2	9.0
Debt securities (bonds and notes)				
2006	12.7	59.7	14.2	13.4
2007	12.5	60.7	13.9	12.9
2008	13.2	53.0	15.4	18.4
2009	16.4	47.5	19.4	16.7
2010	14.9	43.1	21.8	20.2
2011	14.2	42.0	24.1	19.7
2012	14.6	39.8	25.0	20.6
2013	18.0	40.0	20.4	21.6
2014	21.9	33.7	21.6	22.8
2015	22.6	40.0	19.3	18.1
2016	20.2	40.4	22.3	17.1

Note: The figures for Europe include Eastern European nations and Russia.

Source: Compiled on the basis of data from the Bank of Japan.

market, the balance increased to as high as ¥182 trillion at the end of 2016. The balance of domestic debt securities held by overseas investors, long- and medium-term bonds and notes combined, also increased steadily to a total of approximately ¥83 trillion at the end of 2016. Next, in terms of regional breakdown for stocks, the share of American investors has remained at a high level while the downward trend in the share of European investors has come

to a halt. Meanwhile, for debt securities, unlike in the case of stocks, European investors still hold close to 40% of the total despite a downward trend, while American investors' share is around 20%. On the other hand, there recently has been notable growth in the share of domestic debt securities held by Asian investors, which accounted for 22% at the end of 2016, following right behind European investors.

6. Advancing FinTech

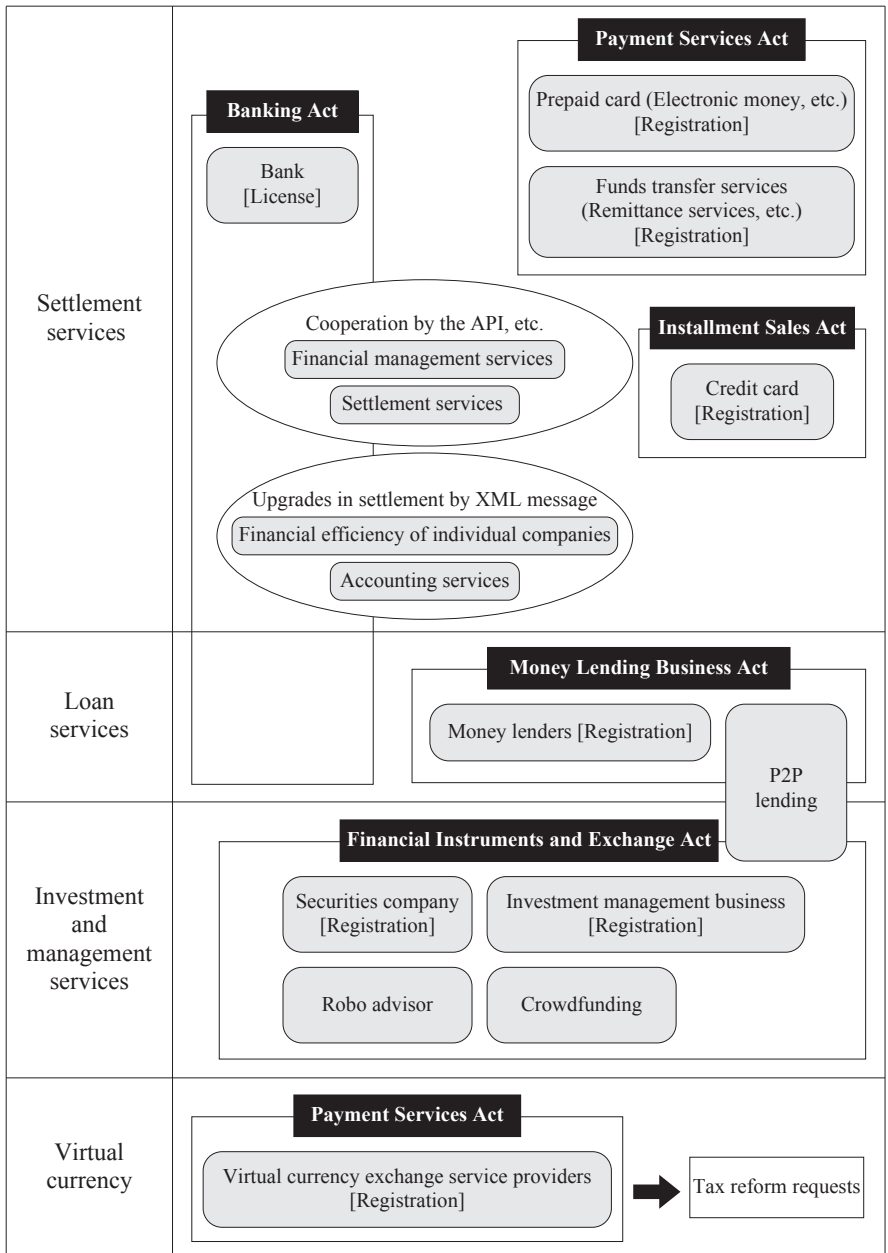
Financial technology, referred to as FinTech, produces innovative financial services that fuse “finance” and information and communication “technology.” With the advancement in IT and the penetration of information infrastructure, FinTech is gaining ground also in Japan. There is a wide range of FinTech-based financial services, including virtual currencies and new settlement services via smartphones. Financial services that are categorized under FinTech can be recognized also in relation to securities trading. The feature common to these services is that a huge volume of data is processed in an optimal manner at low cost and in a short timeframe.

Let's look at some primary examples of securities trading services in which FinTech is applied. Automatic trading of stocks and JGBs using an algorithm is already widely used also in Japan. Recently, algorithm trading which incorporates projections made by artificial intelligence (AI) has been spreading as well. AI is used not only for asset management but also in robo-advisors primarily for individual investors. Several vendors already offer services where AI performs customer profiling online as well as presents the investment policy and the optimal portfolio.

Meanwhile, crowdfunding is a new financing method that developed particularly in the U.S. There are several types of crowdfunding, such as rewards-based and donation. In equity crowdfunding, small amounts of funds are collected from a large number of investors online through the offering of unlisted stocks or handling of private placements. This act of investing in equity crowdfunding is subject to regulation of the Financial Instruments and Exchange Act and the related operations are subject to self-regulation of the Japan Securities Dealers Association. Furthermore, block chain technology is being adopted on a trial basis in certain types of transactions, for example, unlisted stock trading and equity transactions with a low trading frequency on stock exchanges.

Given such rapid advancement of FinTech, financial and securities authorities are taking new initiatives to adapt to this trend. The Financial Services Agency (FSA) implemented a coordinated action by establishing the Working Group on the Financial System of the Financial System Council and

Chart I-3. Japan's Framework Regarding FinTech



Source: Materials released by the Financial Services Agency.

opening the FinTech Support Desk. The FSA also initiated a process to revise its organization (Chapter XVII, Section 3). On the legislative side, the Banking Act and others were revised in 2016, making it easier for the banks to make investments into financial-related IT firms under the Banking Act, etc., as well as introducing regulations on the virtual currency exchange business. Furthermore, the revised Banking Act enacted in 2017 requires financial institutions to make an effort to establish a structure that allows access to their systems through open APIs and put in place a framework for enabling FinTech businesses to safely access account information and transaction data.

CHAPTER II

The History of the Japanese Securities Market

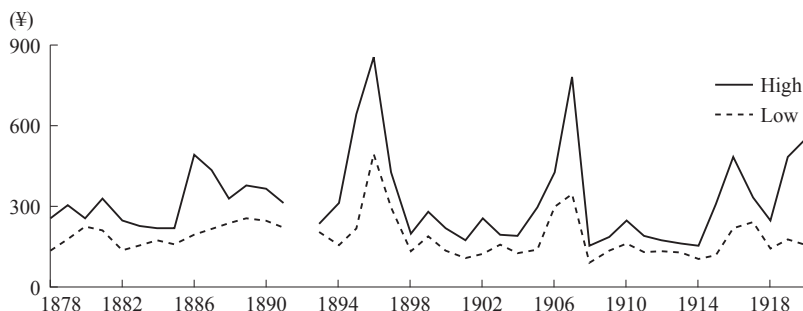
1. The Securities Market in the Prewar Period

If we take the point of origin of Japan's securities market to be the first issuance of securities, it occurred in 1870 with the issue of a foreign currency denominated government bond bearing 9% interest in London, England. If we consider the birth of a secondary market based on a legal ordinance, it happened in 1878 with the establishment of stock exchanges in Tokyo and Osaka. Whichever definition is used, Japan's securities market has been in existence for about 140 years. The stock exchanges started off as markets for trading in public debt, such as old and new public bonds and *Chitsuroku* bonds. Although the stocks of the exchanges and of banks were later listed, public debt accounted for most of the trading for some time. Around 1886, there was a period of rapidly emerging mainly railway and textile companies that ushered in more active trading in stocks.

The formation of corporations (*kabushiki kaisha*) in Japan was not related to the huge capital investments that are required to develop the heavy chemical industry. Instead, the corporation was introduced to deal with the low level of capital accumulation in the economy. In conjunction with that action, schemes were established to facilitate the paying in of capital, such as the stock installment payment system and stock collateral loans. As a result, the corporations set up in the Meiji era were mostly small companies primarily involved in light industry and they really could be considered corporations in name only in terms of their generally intended function of raising capital. The turning point for that function in Japan came with the shift in the composition of industry toward the heavy industry prompted by World War I. Only then did the country see a sharp increase in large albeit mainly financial combine (*zaibatsu*)-related companies with paid-in capital exceeding ¥5 million.

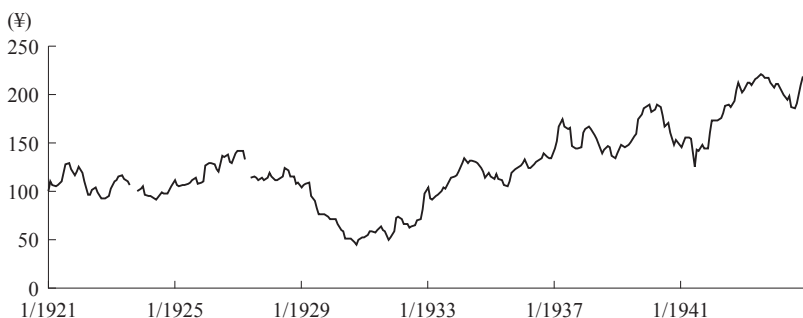
There were practically no shares of major companies listed on stock exchanges in the secondary market because the *zaibatsu* held exclusive ownership of their group companies. And as a result of the lack of investment capital and inadequate credit provision by banks before World War II, the secondary market developed mainly around future trading called settlement

Chart II-1. Changes in Stock Prices (Long-term margin transactions) (1878–1920)



Source: Compiled from *Tokyo shoken torihikisho no nijyunen shi-kisoku to tokei* (A 20-year History of the Tokyo Stock Exchange-Regulations and Statistics).

Chart II-2. Stock Price Movement (Major Stock Price Index) (1921–1944)



Source: Compiled from *Tokyo shoken torihikisho tokei nenpo* (Tokyo Stock Exchange Annual Statistics Reports) and *nisho tokei geppo* (Japan Securities Exchange Monthly Statistics Reports).

dealings and margin transactions. Even the main trading issues of exchanges' stocks were subject to speculative investment. For that reason, the prewar stock market can be characterized as being speculative. Another characteristic that can be pointed out in retrospect is the imposition of wartime regulations. Following the Showa depression, the government sought to achieve economic recovery by devaluing the currency to promote exports and by creating inflation through expansive government spending, principally on the military. After the outbreak of the Sino-Japanese War, the government implemented a wartime regime and imposed regulations on the securities market. The government restricted the issuance of securities for nonessential indus-

Table II-1. Issues Listed on the Tokyo Stock Exchange

(as of end of 1878)

Bonds: New and old public bonds, <i>Chitsuroku</i> public bonds, <i>Kinroku</i> public, bonds, <i>Ki- gyo</i> public bonds
Stocks: Tokyo Stock Exchange, Daiichi National Bank, Tokyo Kabutocho Rice Mer- chant Association, and Tokyo Kakigara-cho Rice Merchant Association

Source: Compiled from *Tokyo shoken torihikisho no gojyunen shi* (A 50-year History of the Tokyo Stock Exchange).

Table II-2. Number of Issues Listed on the Japan Securities Exchange, by Industry

(as of May 31, 1945)

Subscription certificates, 2; banks, trust companies, and insurance companies, 64; investment companies, colonization companies, and securities companies, 28; stock ex- changes, 2; railroad and electric railroad companies, 62; transportation and communica- tion companies, 28; gas and electric utilities, 43; mining companies, 86; shipbuilding and machinery companies, 232; steel companies, metal companies, and smelting com- panies, 81; textile industrial companies, 58; sugar manufacturing and milling compa- nies, 18; food processing companies and fisheries companies, 29; chemical companies, 65; ceramics companies, 25; paper and pulp, printing, and tanning companies, 26; other industrial companies, 31, rubber and tobacco companies, 23; land, building, and ware- housing companies, 17; commercial companies, 46
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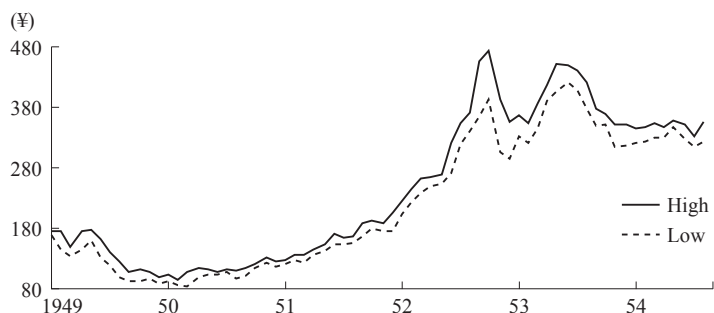
Source: Japan Securities Exchange.

tries, instituted planned corporate bond issuance, put controls on stock prices, and introduced a licensing system for securities companies. Japan's 11 stock exchanges, furthermore, were merged into the Japan Securities Exchange in 1943.

2. The Period of Postwar Economic Rehabilitation (1945–54)

After the war, Japan was placed under the control of the general headquarters (GHQ) of the supreme commander for the Allied powers. There was immediate movement within Japan's securities industry to reopen the market. At one point, in fact, the Ministry of Finance decided to restart the stock exchanges on October 1, 1945. However, the GHQ did not approve of this, and the market was not reopened. The securities industry continued to enthusiastically lobby for a restart of market operations, but the GHQ rejected the idea as

Chart II-3. Stock Price Movements



Source: Compiled from Nomura Securities' *Shoken tokei yoran* (Manual of Securities Statistics).

Table II-3. Number of Members and Listings of Each Exchange at Establishment

	Establishment	No. of members (at the time the fund was established)	Listings
Tokyo Stock Exchange	May 16, 1949	116 official members, 12 specialists	681
Osaka Securities Exchange	May 16, 1949	76 official members, 11 specialists	523
Nagoya Stock Exchange	May 16, 1949	50 official members, 8 specialists	268
Kyoto Stock Exchange	July 4, 1949	41 members	217
Kobe Stock Exchange	July 4, 1949	34 members	189
Hiroshima Stock Exchange	July 4, 1949	28 members	119
Fukuoka Stock Exchange	July 4, 1949	29 members	181
Niigata Stock Exchange	July 4, 1949	24 members	176
Sapporo Securities Exchange	April 1, 1950	17 members	103

Source: Compiled from *shoken torihiki iinkai hokokusho* (a Securities and Exchange Commission Report).

premature and instead gave priority to economic reforms (land reform, dismantling of the *zaibatsu*, and labor reform) and political and social reforms. Consequently, it took nearly four years to reopen the stock exchanges, during which time the Japan Securities Exchange remained closed. This has been the only blank period in the operation of exchanges in the history of the securities market in Japan.

Table II-4. Member Securities Companies at the Establishment of Tokyo Stock Exchange (April 1, 1949)

<p>Nikko Securities, Tamazuka Securities, Yamaichi Securities, Yachiyo Securities, Taguchi Securities, Maruhiro Securities, Nitto Securities, Yamazaki Securities, Kaneju Securities, Irimaru Securities, Yamayoshi Securities, Aizawa Securities, Kokusai Heiwa Securities, Marusui Securities, Toyama Securities, Meiwa Securities, Sekitani Securities, Daiwa Securities, Sekito Securities, Shinko Securities, Nomura Securities, Matsuya Securities, Tokuda Securities, Sanko Securities, Yamaka Securities, Kanaman Securities, Bokutoku Securities, Naruse Securities, Daifuku Securities, Rokushika Securities, Daito Securities, Oda Securities, Tokyo Daiichi Securities, Ninomiya Securities, Yamanakou Securities, Osawa Securities, Obuse Securities, Marusan Securities, Tabayashi Securities, Kakumaru Securities, Koyanagi Securities, Tsukuba Securities, Chiyoda Securities, Nippon Kangyo Securities, Tachibana Securities, Marusugi Securities, Mie Securities, Haratada Securities, Maruya Securities, Fukuyama Securities, Irinaka Securities, Ikko Securities, Rokko Securities, Nippon Sangyo Securities, Toyo Securities, Totan Securities, Toko Securities, Tokyo Showa Securities, Tokyo Shinei Securities, Tokyo Jiyu Securities, Chugai Securities, Marukuni Securities, Ikanagashira Securities, Kaga Securities, Kadoman Securities, Yoshikawa Securities, Yoshimura Securities, Taihei Securities, Taiyo Securities, Tanaka Securities, Takai Securities, Taishichi Securities, Taisei Securities, Naiga Securities, Nakahara Securities, Nakajima Securities, Hachisu Securities, Ueno Securities, Ono Securities, Osaka Shoji, Oda Securities, Yamani Securities, Yamawa Securities, Fukuri Securities, Yamamaru Securities, Yamafumi Securities, Yamasachi Securities, Yamasan Securities, Marutoyo Securities, Maruwa Securities, Marusan Securities, Maruju Securities, Matsui Securities, Fuso Securities, Koiei Securities, Ebisu Securities, Ando Securities, Yamata Securities, Sanshin Securities, Sansei Securities, Sakai Securities, Kyowa Securities, Kyodo Securities, Misawayama Securities, Miki Securities, Shimizu Securities, Shinei Securities, Jujiya Securities, Juzen Securities, Joichi Securities, Jonan Securities, Hinode Securities, Hiyama Securities, Hirahara Securities, Central Securities, Marugo Securities</p> <p>Specialists: Daiichi to Daijuni Jitsuei Securities</p>

Source: Compiled from *Tokyo shoken torihikisho no jyunen shi* (A 10-year History of the Tokyo Stock Exchange).

Despite trading being halted on the floors of the stock exchanges and official secondary market, the demand for securities trading persisted even in the confusion of postwar Japan. Securities trading naturally emerged at the offices of securities companies in the form of over-the-counter (OTC) trading. When it became clear, moreover, that the stock exchanges were not going to restart anytime soon, “group transactions,” which involved institutionalized OTC trading at fixed places and times in parallel with the OTC trading at individual securities companies, also got under way. By the end of 1945, group transactions, which first emerged in Tokyo and Osaka, had spread to exchanges in Nagoya, Niigata, Kyoto, Kobe, Hiroshima, and Fukuoka, among others.

It would, of course, have been difficult to reopen the stock exchanges merely by continuing the prewar exchange organization and securities legislation. To democratize the securities industry, the Japanese government commenced the formulation of a new legal framework. In 1947, it promulgated

the Securities and Exchange Law, which drew on the Securities and Exchange Act of the United States. Initially, only those articles of the law dealing with the Securities and Exchange Commission, which was patterned after the U.S. Securities and Exchange Commission (SEC), were enforced. Then a full-scale revision of the law was promulgated in 1948. This amended law formed the legal framework for the new postwar securities market, replacing the licensing system for securities companies with a system of registration with the regulatory authority and putting in place such regulations as the separation of banking and securities businesses.

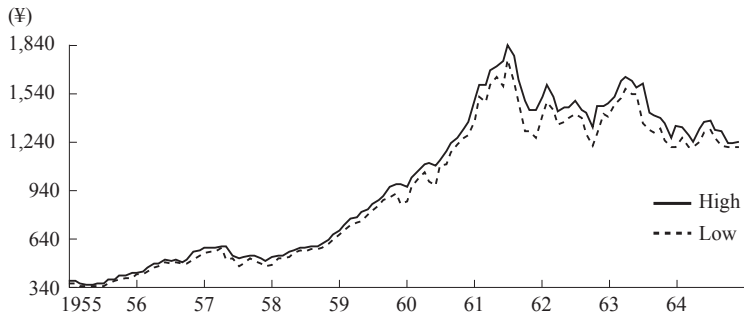
Stock exchanges were established in Tokyo, Osaka, Nagoya, and other cities from May 1949. The GHQ, however, instructed Japan's Securities and Exchange Commission to ensure the strict observance of its Three Principles of Market Operation: (1) recognize transactions in order of occurrence, (2) concentrate trading on exchanges, and (3) prohibit futures trading. All exchanges pledged to strictly follow these principles, enabling the long-awaited reopening of stock exchanges (participants in group transactions and the issues they had traded moved en masse to these stock exchanges and restarted trading on a cash transaction basis only). Because, however, it was difficult to match buys and sells based only on actual demand, a movement got under way in the industry to push for the revival of prewar margin transactions for the purpose of introducing temporary demand. Since the management of the exchanges and the GHQ were against this proposal, a margin trading system modeled on the U.S. margin trading system was introduced in 1951.

3. The Securities Market during the First Period of Rapid Economic Growth (1955–64)

As made clear in the title of an economic white paper issued in 1956, *The Post-War Period Is Over*, in the first half of the 1950s Japan had finished with its postwar recovery and was heading into its first period of rapid economic growth. Japan's *Jinmu* and *Iwato* booms in the mid-1950s and from 1958 to 1961, respectively, were representative of the change. Against a backdrop of favorable growth in corporate performances, stock prices rose almost universally during the period from the latter half of 1955 to July 1961. An investment trust boom at the time also contributed to the rising securities market.

Japan had introduced a postwar securities investment trust system in 1951, but the market for these investment trusts struggled until 1955. From 1956 on, however, stock prices surged, and the outstanding principal of investment trusts expanded sharply. Investment trusts became such a force in the securities market that they were referred to as "the whale in the pond." Another factor in the bull market was the system of "investable custody." Under that

Chart II-4. Stock Price Movements (TSE's Modified Stock Price Average) (1955–1964)



Source: Compiled from Nomura Securities' *Shoken tokei yoran* (Manual of Securities Statistics).

Table II-5. Changes in Assets of Stock Investment Trusts and Bond Investment Trusts (Principal basis)

(millions of yen)

	Stock Investment Trusts					Bond Investment Trusts				
	Sales (A)	Cancellation (B)	Redemption (C)	Year-end Principal	Net asset change (D=A– (B+C))	Sales (A)	Cancellation (B)	Redemption (C)	Year-end Principal	Net asset change (D=A– (B+C))
1955	26,381	31,792	13,640	59,519	– 19,051					
1956	51,431	27,163	16,039	67,748	8,229					
1957	92,544	16,178	7,199	136,915	69,166					
1958	106,412	25,741	7,890	209,695	72,780					
1959	182,480	58,876	3,219	330,081	120,385					
1960	362,066	87,945	–	604,202	274,120					
1961	588,205	155,751	9,810	1,026,845	422,643	244,490	88,470	–	156,020	156,020
1962	347,116	229,174	14,161	1,130,627	103,781	83,819	107,160	–	132,679	– 23,341
1963	331,873	274,226	17,884	1,170,388	39,761	109,857	71,021	–	171,515	38,836
1964	330,158	293,573	45,415	1,161,558	– 8,829	122,332	84,811	–	209,036	37,521
1965	196,829	349,502	42,556	966,328	– 195,229	120,665	110,132	–	219,569	10,533

Source: Compiled from *Shokenshintaku sanjyunen shi* (30-year History of Securities Investment Trusts).

Table II-6. Categories of Investible Custody Securities and Investment Uses

(millions of yen)

	Total Assets Under Management	Category			Investment Area	
		Special debt	Of above, bank debentures	Corporate bonds	Deposited collateral	Others
Sept. 1958	62,701	61,984	61,384	568	53,812	5,283
Sept. 1959	108,347	107,602	105,381	673	88,793	19,420
Sept. 1960	146,076	144,875	141,666	969	116,061	30,015
Sept. 1961	139,833	138,552	134,794	1,239	116,988	22,845
Sept. 1962	154,284	152,127	143,946	2,005	129,030	25,254
Sept. 1963	209,197	205,337	196,967	3,386	156,319	52,877
Sept. 1964	249,079	244,685	235,557	3,714	195,891	53,189

Source: The Securities Bureau of the Ministry of Finance, *Nenpo* (Annual Report).

system, securities companies borrowed bank debentures (primarily discount bank debentures) that they had sold in the market on a commission basis from unspecified multiple customers for a predetermined fee through a custody system. The securities companies then raised capital from small and medium-sized financial institutions or in the call money market by using the bank debentures as collateral and invested it in stocks or bonds through their own proprietary trading accounts. In this manner, against the backdrop of an expanding economy and bullish securities market, OTC trading value rose sharply, and the number of companies approved to sell their securities OTC grew rapidly, concentrated mainly on start-up and growth companies. To deal with the rapid expansion in the OTC market, the Tokyo, Osaka, and Nagoya stock exchanges each established Second Sections.

Japan, though, was striving to balance its current account, and when the balance of payments fell into the red it tightened the money supply. When the interest rate was raised in July 1961 to improve the balance of international payments, Japanese companies began liquidating their stockholdings. In combination with corporations' focus on increasing capital, this trend caused a worsening in the demand-supply balance for stocks. The resultant drop in stock prices forced an end to the investment trust boom, as the mechanism that had been driving up stock prices reversed and caused further declines in stock prices. The increase in the official discount rate also produced a rise in the number of redemptions of bond investment trusts, especially by companies. This action placed a great financial burden on the securities companies,

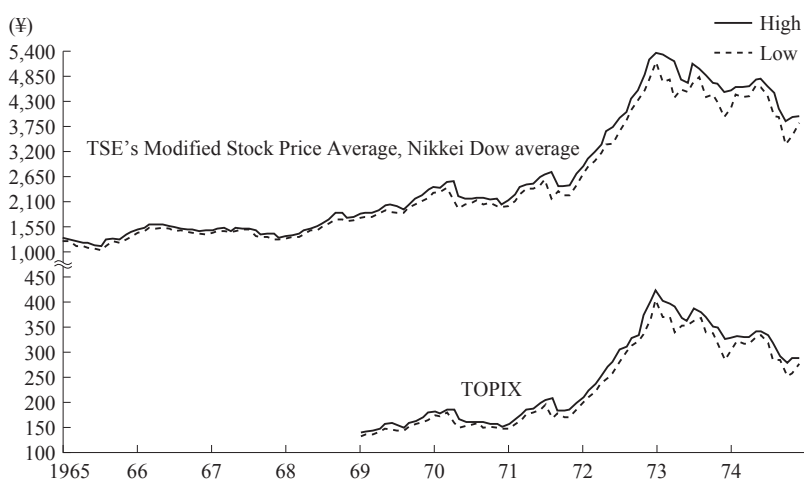
which were forced to buy bonds that were being removed from the pool of investment trust assets. These factors became a cause of panic in the securities market.

For that reason, the market took such steps as urging business corporations to rearrange their financing plans (cutting back or postponing their planned increase of capital) and persuading commercial banks to make loans secured by bonds to four bond investment trusts. Despite these efforts, stock prices kept declining, partially because of the market reaction to the assassination of U.S. President Kennedy. To deal with the issues, the industry formed stock purchasing organizations. In January 1964, banks and securities companies contributed capital to create the Japan Joint Securities Co., Ltd., while in January 1965 a group of securities companies jointly established the Japan Securities Holding Association. Both of these organizations carried out share purchasing operations in the market and assumed ownership of shares held by investment trusts with the aim of improving the demand and supply balance in the stock market. In the latter part of May 1965, however, the news that Yamaichi Securities Co., Ltd., was on the verge of bankruptcy hit the market, plunging it into a state of panic.

4. The Securities Market during the Second Period of Rapid Economic Growth (1965–74)

The curtain opened on the 10-year period from 1965 onward with a securities panic. At the end of the first half of fiscal 1964 (September 30, 1964), the cumulative earnings of securities companies in Japan amounted to a loss of ¥26.4 billion. And Yamaichi Securities' performance had deteriorated particularly badly; by March 31, 1965, the company had racked up a loss of ¥28.2 billion, compared with total capital of only ¥8 billion. On May 21, 1965, it finally was revealed that Yamaichi Securities was on the brink of failure. To avoid a loss of confidence in the market, a move was made to bail the company out. In the late night on May 28, the government invoked Article 25 of the Bank of Japan Act and announced that Yamaichi Securities would receive a special loan from the Bank of Japan without any required collateral and for an unlimited amount (in actual fact some collateral was secured). Stock prices continued to fall for some time following the announcement but staged a rally when the government made clear that it intended to issue deficit-covering bonds for the first time since the war. Meanwhile, the panic in the securities market also served as the basis for a reorganization of the securities industry. The government amended the Securities and Exchange Act, introducing a licensing system for securities companies. This forced many securities companies to combine their operations, or merge, to prepare for the

Chart II-5. Stock Price Movement (TSE's Modified Average, Nikkei Dow, TOPIX) (1965–1974)



Source: Compiled from data the *Shoken tokei yoran* (Manual of Securities Statistics), the *Nihon Keizai Shinbun*, and the *Tosho tokei nenpo* (TSE Annual Report).

new system. In combination with the securities companies that had their registration revoked around the time of the securities panic and those that dissolved their operations, the number of securities companies at the time of the conversion to the new licensing system declined to 277 companies, compared with 593 companies at the end of 1963.

During the decade from 1965 to 1974, progress was made in internationalizing Japan's securities market. In 1964, Japan became an Article 8 country member of the International Monetary Fund (IMF), joined the Organization for Economic Cooperation and Development (OECD), and publicly promised to liberalize capital transactions. Consequently the government implemented measures to liberalize the capital market in five stages beginning in July 1967. This process steadily eased the restrictions on ownership of Japanese stock by foreigners, and they were finally fully lifted with the exception of certain stock categories. The liberalization of capital transactions was not limited to foreign investors; foreign issuers and intermediaries were also able to operate in Japan's securities market. In 1970, the Asian Development Bank started issuing yen-denominated foreign bonds in Japan. Foreign corporations followed suit and began to offer their shares in 1972. The Tokyo Stock Exchange established a Foreign Section for them in 1973. Around the same time, foreign securities companies commenced setting up operations in Japan. Merrill Lynch opened a Tokyo branch in 1972, becoming the first for-

Table II-7. Changes in Number of Securities Companies

	Changes in the number of companies		Companies at financial year-end	Number of Business Offices	Total Capital (in ¥ mil.)	Per-Company Capital (¥ mil.)
	Increase	Decrease				
FY1948	959	11	948			
1949	292	113	1,127	1,889	3,014	2.7
1950	18	209	936	1,601	3,454	3.7
1951	11	109	838	1,642	3,767	4.5
1952	71	73	836	1,794	6,683	8.0
1953	52	52	836	2,105	10,115	12.1
1954	11	83	764	1,997	10,713	14.0
1955	2	66	700	1,901	10,826	15.5
1956	7	55	652	1,848	12,022	18.4
1957	7	77	582	1,904	18,062	31.0
1958	7	32	557	1,984	19,569	35.1
1959	15	26	546	2,233	29,221	53.5
1960	36	30	552	2,565	39,094	70.8
1961	48	10	590	2,841	74,991	127.1
1962	23	12	601	2,934	78,114	130.0
1963	8	16	593	2,893	100,573	169.6
1964	0	82	511	2,424	126,118	246.8
1965	0	86	425	2,109	125,599	295.5
1966	2	30	397	2,009	118,632	298.8
1967	0	113	284	1,869	119,955	422.4
1968	0	7	277	1,572	119,904	432.9

Note: Figures for "Number of Business Offices" and "Capital" for the years preceding 1959 are as of the end of the calendar year concerned.

Source: The Securities Bureau of the Ministry of Finance, *Nenpo* (Annual Report).

Table II-8. Changes in Stock Ownership Among Investor Categories

By Owner		FY	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
National and local government organizations			0.3%	0.2%	0.3%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%
Corporations	Financial institutions		26.8%	29.8%	30.6%	32.0%	31.9%	32.3%	33.9%	35.1%	35.1%	35.5%	36.0%
	Securities companies		5.4%	5.4%	4.4%	2.1%	1.4%	1.2%	1.5%	1.8%	1.5%	1.3%	1.4%
	Business corporation, etc.		21.0%	18.6%	20.5%	21.4%	22.0%	23.1%	23.6%	26.6%	27.5%	27.1%	26.3%
	Foreign corporations		1.9%	1.7%	1.7%	2.1%	3.1%	3.0%	3.4%	3.4%	2.8%	2.4%	2.5%
Corporate investor total			55.1%	55.5%	57.2%	57.6%	58.4%	59.6%	62.4%	66.9%	66.9%	66.3%	66.2%
Individual	Individuals and others		44.4%	44.1%	42.3%	41.9%	41.1%	39.9%	37.2%	32.7%	32.7%	33.4%	33.5%
	Foreign investors		0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%
Individual investor total			44.6%	44.3%	42.5%	42.1%	41.3%	40.1%	37.4%	32.8%	32.8%	33.5%	33.6%

Note: Investment trust portion is included in financial institutions.

Source: Compiled from *Kabushiki bunpu jokyo chosa* (Survey of Stock Distribution Status).

eign securities company to receive a securities business license in Japan.

The liberalization of capital transactions also meant that it was now possible for foreign companies to acquire Japanese companies. Japanese companies countered this new possibility by focusing on building stable shareholder bases. If companies held shares in each other, this reduced the number of shares available in the market, making it easier to defend against takeover attempts. Share crossholdings were viewed from the perspective of takeover prevention. Later, after Japanese companies switched the form of their capital increases from making rights issues to existing shareholders at par value to making public offerings of stock at market prices, issuers also pursued share crossholdings from the point of view of the desirability of high share prices when floating shares at market value. As a result, there was a change in the shareholding composition of the market, with the proportion of corporate shareholdings increasing and the proportion of individual investor shareholdings declining.

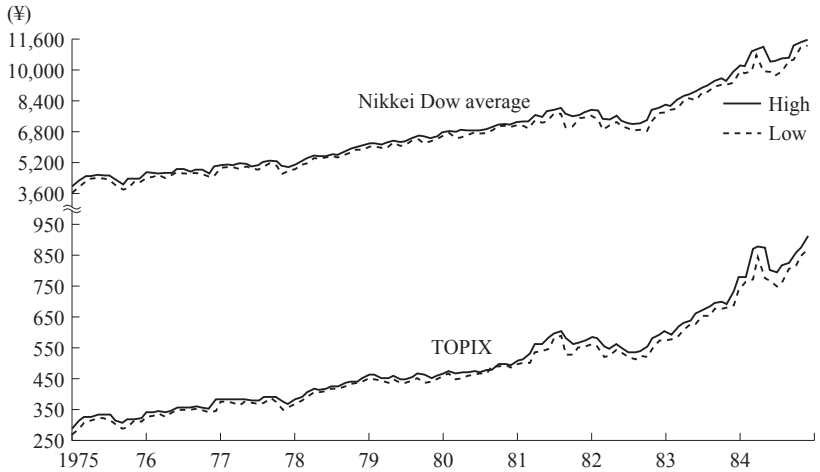
5. Measures Taken to Cope with the Oil Crisis (1975–84)

At the end of the previous 10-year period, there had been a succession of major events that shook the Japanese economy, including the Nixon Shock (1971), the introduction of a floating exchange rate system (1973), and the first oil shock (1973.) A second oil shock occurred later, in 1979. With Japanese companies practicing energy conservation management in the face of back-to-back oil crises, the government seemed intent on getting through the crises using a fiscal expansion strategy. Underpinning that strategy was the massive issuance of deficit-covering Japanese government bonds (JGBs).

As previously mentioned, government bond issuance after the war got started in fiscal 1965. The main feature of those bonds was that they were issued at low interest rates without regard to market conditions and were forcibly allocated among financial institutions belonging to the underwriting syndicate according to their capital strength. Maintaining this artificially fixed, low interest rate market meant that financial institutions could not be permitted to sell the JGBs in the market freely. Since at the time the government was trying to keep JGB issuance within the scope of the growth in the money supply, the Bank of Japan was purchasing almost all JGBs that had been held by the financial institutions for more than one year (liquidity policy). The reason, in fact, that JGB issuance after the oil shocks was called massive was that JGB issuance from fiscal 1975 on exceeded growth in the money supply.

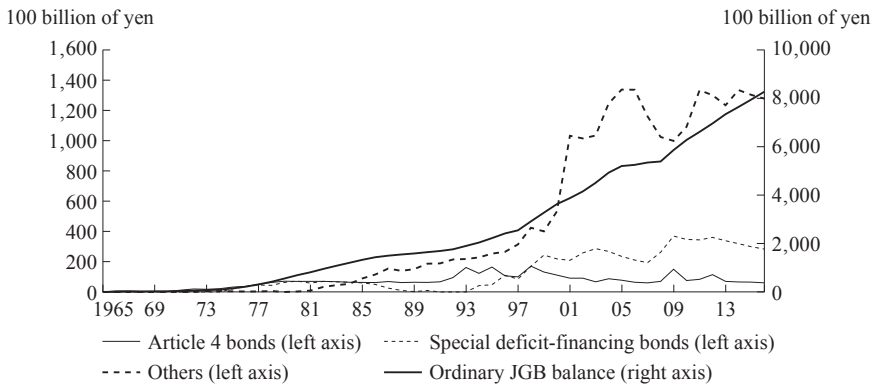
With the massive issuance of JGBs, the liquidity policy reached its limits, making it impossible to avoid issuing JGBs in the public market. Accordingly, the government approved, with some restrictions, JGB sales on the bond

Chart II-6. Stock Price Movement (Nikkei Dow and TOPIX) (1975–1984)



Source: Compiled from data from the *Nihon Keizai Shimbun*, the *Tosho tokei nenpo* (TSE Annual Report), and the *Shoken tokei yoran* (Manual of Securities Statistics).

Chart II-7. Change in JGB Issuance and Outstanding Balance



- Notes: 1. JGB issuance amounts are calculated on a proceeds basis.
 2. Special deficit-financing bonds include temporary-bridging, tax-reduction offset, and disaster-recovery special public bonds.
 3. Others represents the total of pension plan funding special deficit-financing bonds, reconstruction bonds, FILP bonds, and refunding bonds.

Source: The web site of Japan's Ministry of Finance.

market in 1977. Following this change, the restrictions on sales were liberalized in stages, resulting in the deregulation of the JGB secondary market. The interest rate yields for JGB subscribers, on the other hand, were the base rates given by the regulated interest rate structure in Japan. To deregulate these rates would force the government to change its artificially regulated interest rate policy. For that reason, there was a great deal of resistance to the deregulation of the JGB primary market within the government, and deregulation proceeded at a snail's pace. When, however, the designated underwriting syndicate refused to underwrite the planned issuance of JGBs in June 1981, the issuance conditions for JGBs were deregulated, setting the stage for the deregulation of the different types of long-term interest rates.

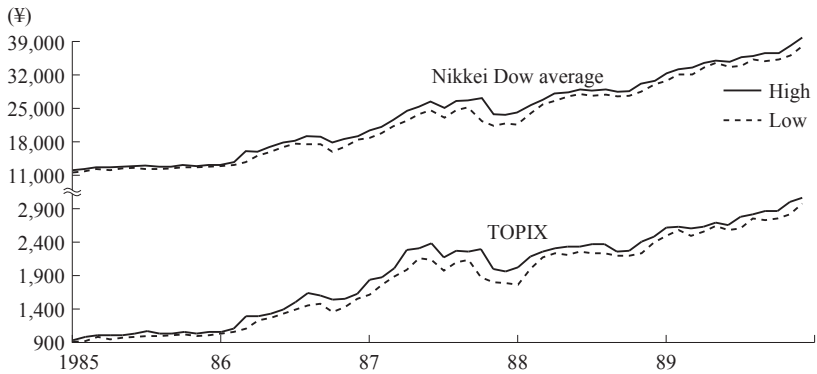
Internationalization proceeded at this time. During the period from 1975 to 1984, Japan's trade surplus with the United States ballooned, causing trade and economic friction between the two countries. Perceiving the reason for the problem to be the closed nature of Japan's financial, capital, and service markets, the United States demanded the overall reform of Japan's economic structure. As part of that process, the two countries formed the Japan-U.S. Yen/Dollar Committee. The United States argued that deregulated financial and capital markets driven by a market mechanism would enable the optimum allocation of capital in Japan. It therefore pushed strongly for the removal of various restrictions placed on those markets by the Japanese government that it considered obstructive to open markets. In this manner, internationalization formed the basis for financial deregulation in Japan.

6. Developments before and after the Economic Bubble (1985–89)

In a Japan-U.S. Yen/Dollar Committee Report released in 1984, the United States brought pressure on Japan to liberalize its financial and capital markets and to internationalize the yen. The Japanese government responded by liberalizing the domestic financial market through such actions as deregulating interest rates on bank deposits. It also moved to improve foreign financial institutions' access to the Japanese market through such measures as opening up membership on the Tokyo Stock Exchange (TSE). As a first step toward internationalizing the yen, the government liberalized the Euroyen market. The TSE, meanwhile, heeded the request of the government to open its membership by revising the fixed number of membership seats in its Articles of Incorporation in 1985 and accepting its first round of new members. A total of three rounds were eventually conducted, resulting in seats on the TSE for 25 foreign securities companies.

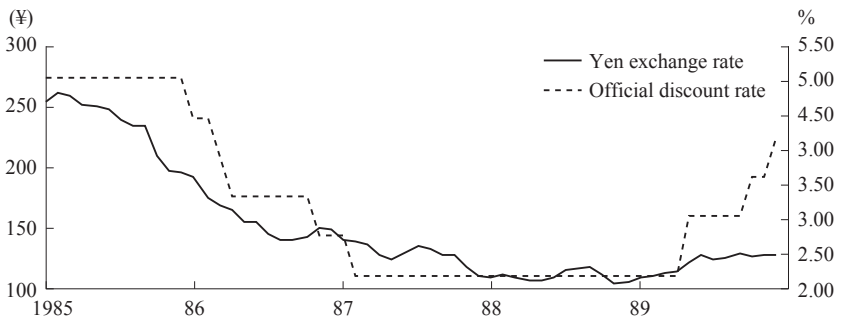
The deregulation of interest rates began in 1985 with the deregulation of interest rates on large deposits. After that, the deregulation of interest rates on

Chart II-8. Stock Price Movement (Nikkei Dow and TOPIX) (1985–1989)



Source: Compiled from data from the *Nihon Keizai Shimbun* and the *Shoken tokei yoran* (Manual of Securities Statistics).

Chart II-9. Yen to US\$ Exchange Rate and Japan's Official Discount Rate



Source: Web site of the Bank of Japan.

deposits progressed rapidly. As a result, the Bank of Japan's open interest rate for fund raising jumped to 53% in 1989, from 7.5% at the end of 1984, greatly increasing fund procurement costs for banks. Major corporations concurrently shifted their financing from bank loans to security issuance, resulting in a decline in the balance of loans being extended by major banks to their core customer base (heavy industry). To cope with the loss of business, the leading Japanese banks expanded the scope of their loan operations to include real estate, construction, and other industries and launched international operations. They also began planning to enter the securities business, creating friction between the banking and securities industries.

Table II-9. Stock Trading Composition by Investor Category

(100 million shares)

	Total Brokerage Trading	Individuals	Foreigners	Life and Non-Life Insurance Companies	Banks	Investment Trusts	Corporations	Others
1983	1,250.7	59.5%	15.9%	1.3%	3.5%	4.4%	9.3%	6.1%
1984	1,344.5	54.6%	17.3%	1.2%	5.3%	4.4%	11.5%	5.7%
1985	1,615.6	49.5%	15.4%	1.2%	10.6%	5.0%	11.6%	6.6%
1986	2,772.0	41.7%	13.8%	1.1%	16.1%	5.4%	15.4%	6.5%
1987	3,683.4	36.8%	12.4%	1.0%	21.5%	5.6%	17.0%	5.8%
1988	3,979.2	34.8%	9.1%	1.2%	24.7%	6.8%	17.7%	5.7%
1989	3,395.1	32.3%	10.8%	1.2%	25.4%	10.0%	14.6%	5.7%

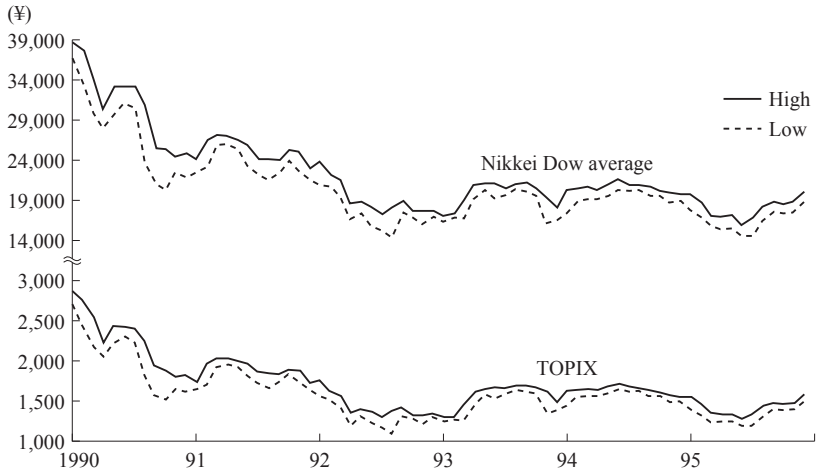
Note: Total brokerage trading equals the buying and selling of all securities companies on the first and second sections of the TSE, Osaka, and Nagoya exchanges.

Source: Compiled from the *Tōsei yoran* (Tokyo Stock Exchange handbook).

In 1985, the Plaza Accord was signed, after which the yen appreciated sharply against the U.S. dollar. The rate movement raised concerns about a strong yen-related economic recession in highly export-dependent Japan. The Bank of Japan's reaction was to implement successive reductions in the official discount rate from January 1986 onward, and the economy responded by entering a recovery phase. Amid this low interest rate climate, Black Monday rocked the U.S. market on October 19, 1987, causing nations around the world to initiate monetary easing to avert recessions. Japan, meanwhile, was still in an economic recovery phase, and its official discount rate remained at a low level. Consequently, the price of land and stocks continued to rise. Against this backdrop of asset inflation, corporations began taking advantage of their ability to raise capital through bank loans and securities, using financial engineering, or *zaitech*, to boost their financial income. Financial institutions, hurt by the decline in loan balances, also aggressively invested capital in securities. Heated investment in securities pushed the Nikkei Dow index up from ¥12,716.52 (September 30, 1985) before the Plaza Accord to a record high of ¥38,915.87 at the end of 1989.

New trading methods were also introduced during this period, commencing with bond futures trading in 1985. Stock index futures trading was introduced in 1987, and stock index options in 1989. Japan's securities market thus gained a full complement of cash, future, and options trading.

Chart II-10. Stock Price Movement (Nikkei Dow and TOPIX) (1990–1995)



Source: Compiled from data from the *Nihon Keizai Shimbun* and the *Shoken tokei yoran* (Manual of Securities Statistics).

7. The Reform of the Financial System after the Stock Market Scandals (1990–95)

The debate on financial system reform began in Japan in the mid-1980s. It arose in response to the global trend toward financial deregulation and to the change in the financing methods of Japanese corporations. The Financial System Research Council took the lead in the debate and considered revisions in the specialized financial institution systems that separated long-term interest rates from short-term interest rates, commercial banks from trust banks, and the banking industry from the securities industry. These systems were the pillars of the postwar financial system in Japan. The Financial System Research Council, however, was positive about banks being allowed to enter the securities business and decided that the best approach would be to allow mutual entry into the banking, trust and securities businesses based on wholly owned subsidiaries. It requested the Securities and Exchange Council to revise the system separating the banking and securities industries. But the Securities and Exchange Council was wary of allowing banks into the securities business, recognizing that the securities industry overall was far less enthusiastic about this idea than the banking industry. The Securities and Exchange Council nevertheless decided to approve mutual entry through subsidiaries on the condition that firewalls were established between subsid-

Table II-10. Establishment of Securities Subsidiaries of Banking Institutions

Month/Year	Companies Starting New Securities Business
Jul. 1993	IBJ Securities (currently Mizuho Securities), LTCB Securities (currently UBS Securities), and Nochu Securities (currently Mizuho Securities)
Nov. 1993	Sumitomo Trust Securities (liquidated in 2000) and Mitsubishi Trust Securities (currently Mitsubishi UFJ Morgan Stanley Securities)
Jul. 1994	Asahi Securities (dissolved in 1999)
Aug. 1994	Yasuda Trust Securities (currently Mizuho Securities)
Nov. 1994	Sakura Securities (currently Daiwa Securities), Sanwa Securities (currently Mitsubishi UFJ Morgan Stanley Securities), Daiichi-Kangyo Securities (currently Mizuho Securities), Fuji Securities (currently Mizuho Securities), Mitsubishi Diamond Securities (currently Mitsubishi UFJ Morgan Stanley Securities), and Sumitomo Capital Securities (currently Daiwa Securities)
Mar. 1995	Tokai International Securities (currently Mitsubishi UFJ Morgan Stanley Securities)
Apr. 1995	Hokkaido Takushoku Securities (dissolved in 1998)
May 1995	Mitsui Trust Securities (terminated business in 1999)
Oct. 1995	Toyo Trust Securities (liquidated in 1999)
Nov. 1996	Shinkin Securities and Yokohama City Securities (both liquidated in 1999)
Aug. 1997	Tokyo Forex Securities (currently ICAP Totan Securities), and Nittan Brokers Securities (currently Central Totan Securities)
Nov. 1997	Ueda Tanshi Securities (dissolved in 2001)
Oct. 1998	Hitachi Credit Securities (currently DBJ Securities)

Source: Compiled from data from the *Nihon Keizai Shimbun*, the Securities Bureau of the Ministry of Finance, Nenpo (Annual Report). “The First Year of the Financial Supervisory Agency”, and “The First Year of the Financial Services Agency.”

aries and parent companies. And for the time being bank subsidiaries, including indirectly owned subsidiaries, were prohibited from operating in the stock brokerage market. The Institutional Reform Law was enforced in June 1992 based on those conditions, and mutual entry into these financial sectors became a reality.

Around the time that the debate on financial system reform was dying down, the uncovering of major financial and securities scandals shook the banking and securities industries. For the securities industry it was the discovery through a tax audit that during the financial bubble major securities companies had been compensating their largest corporate clients for losses incurred (in August 1991, total compensation by the four major securities companies and 17 second-tier and medium-sized companies had reached approximately ¥172 billion). Dealings with members of known crime syndicates and market manipulation charges also surfaced, escalating the problems into a social issue. Most of the loss compensation was done through *eigyo*

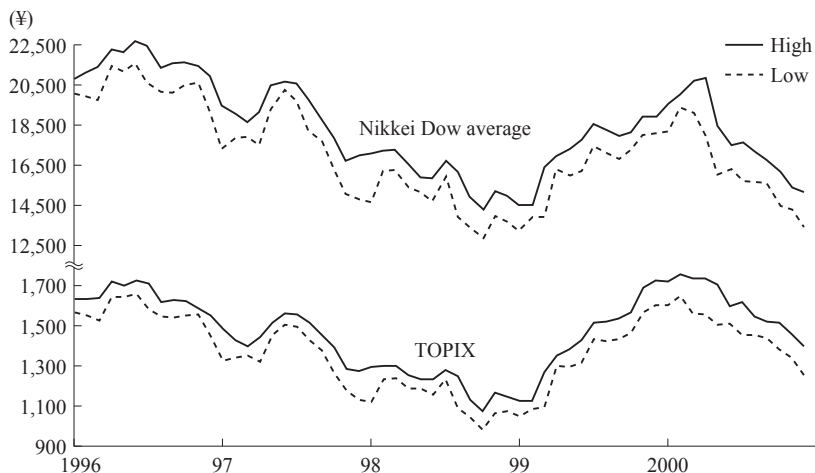
tokkin accounts (discretionary accounts managed by the securities company for *tokkin*, a form of corporate investment fund). The commonly used methods involved arranging to have the client earn a profit on transactions disguised as bond transactions or shifting losses between corporate clients with differing fiscal year-ends to avoid reporting the loss by temporarily transferring securities with losses at book value between their accounts in a process called *tobashi*.

Since under the existing law loss compensation for trades after the fact was not illegal, the Securities and Exchange Act was immediately amended to ban securities trading under a discretionary account and loss compensation before or after the fact. Criticism mounted that “excessive profits due to the regulator’s protection of market participants, problematic administration, and fixed rate commissions had made loss compensation possible,” and it was said that “what the solution requires is not the banning of loss compensation or the punishment of securities companies, but the implementation of financial system reform itself.” In September 1991, the Provisional Council for the Promotion of Administrative Reform recommended the liberalization of brokerage commissions, the promotion of new market entries, and the separation of the market surveillance organization from the Ministry of Finance. In July 1992, the authorities established the Securities and Exchange Surveillance Commission. The rest of the Provisional Council’s recommendations were included in the financial Big Bang reforms that came later, contributing to the formation of a new framework for Japan’s financial and capital markets.

8. The Debate on, and Enforcement of, the Act on Revision, etc. of Related Acts for the Financial System Reform (1996–2000)

The bursting of the economic bubble left deep scars on the economy. The trauma from the collapse of stock prices emerged in the form of securities scandals, while that from the collapse of land and real estate prices emerged as the nonperforming loan problem in the financial industry. The nonperforming loan problem in particular lingered without the implementation of any fundamental solution - the banking industry struggled for close to 10 years to get out from under its bad debt. During this long process, foreign companies and investors and financial transactions flowed out of the Japanese market, making the hollowing out of the financial market real. Japan’s way of addressing the issue was the financial Big Bang initiative proposed by then prime minister Ryutaro Hashimoto in 1996. The goals of the initiative were to wrap up the cleanup of nonperforming loans by 2001 and rebuild the Japanese financial market into an international market comparable to the

Chart II-11. Stock Price Movement (Nikkei Dow and TOPIX) (1996–2000)



Source: Compiled from data from the *Nihon Keizai Shimbun* and the *Shoken tokei yoran* (Manual of Securities Statistics).

New York and London markets based on the principles of “free, fair, and global.”

Discussions on financial reform took place in the Securities and Exchange Council, the Financial System Research Council, the Insurance Council, the Council on Foreign Exchange and Other Transactions, and the Business Accounting Council. Those discussions resulted in recommendations to change Japan’s established bank intermediation-based capital allocation system (indirect financing) to a market-based capital allocation system (direct financing). Passed in October 1998, the Act on Revision, etc. of Related Acts for the Financial System Reform, paved the way for services based on vigorous intermediation, set up a market system with special characteristics, and established a framework for trading that users could trust. Among its many revisions, the deregulation of stock brokerage commissions and the shift to for securities business provided incentive for securities companies to reform their business models. Its elimination of the obligation to trade stocks only on exchanges, on the other hand, promoted competition between markets.

Almost at the same time as the financial Big Bang initiative was being proposed, major financial institutions experienced business and financial crises that led to bankruptcies. Among troubled banks were Hokkaido Takushoku Bank, Ltd., the Long-Term Credit Bank of Japan, Ltd., and the Nippon Credit Bank, Ltd. The list of securities companies included second-tier Sanyo Securities Co., Ltd., and one of the four major securities companies, Ya-

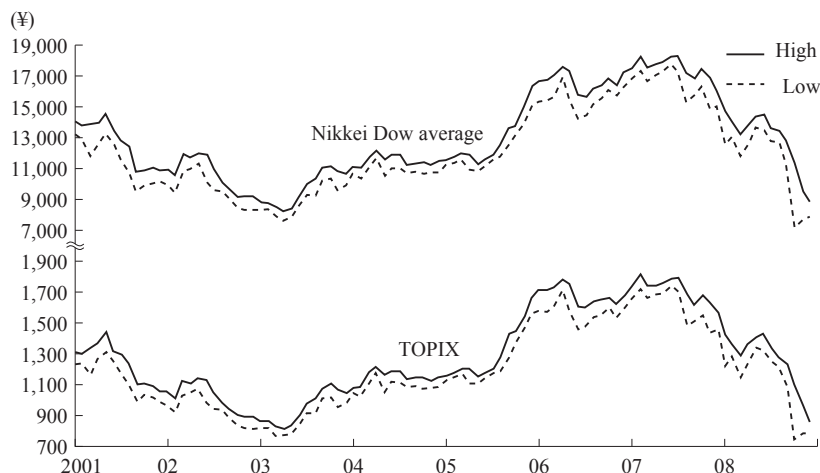
Table II-11. Schedule for Reforming the Securities Market During the Big Bang

	FY1997	FY1998	FY1999	FY2000	FY2001
I. Investment Vehicles (Attractive investment instruments)					
1. Diversity of the types of bonds					
2. Diversity of derivatives products					
3. Developing Investment Trust Products					
(1) Introduction of Cash Management Account (wrap account)					
(2) OTC sales of investment trusts products by banks					
(3) Private placement of investment trusts					
(4) Investment company type funds					
4. Review of the definition of securities					
5. Enhancement of corporate vitality and efficient use of capital					
II. Markets (An efficient and trust framework for transactions)					
1. Improvement of transaction system on stock exchanges					
2. Improvement of OTC (JASDAQ) market system					
3. Deregulation of sales solicitations by securities firms for unlisted, unregistered stock					
4. Improvement of share lending market					
5. Improvement of clearing and settlement system					
6. Strengthening inspection, surveillance and enforcement systems					
7. Strengthening disclosure					
III. Financial Intermediaries (Diverse investment services to meet client needs)					
1. Deregulating brokerage commissions					
2. Diverse activity by intermediaries					
3. Use of holding company structure					
4. Strengthening asset management					
5. Enhancing monitoring system for soundness of securities companies					
6. Entry regulations for securities companies					
(1) Licensing system reform					
(2) Enhancing mutual entry into banking, securities and trust businesses					
7. Investor protection related to exits of intermediaries from the market					
(1) Strict separation of client assets from securities companies' own assets					
(2) Enhancing the securities Deposit Compensation Fund scheme					
Review of the taxation related to securities					
Shift to the new administrative regime					

Source: Drawn from the Securities and Exchange Council's report "Comprehensive Reform of the Securities Market—For a Rich and Diverse 21st Century"

maichi Securities Co., Ltd. These companies previously would have been rescued by being absorbed by or merged with other major financial institutions. But there were no financial institutions with the financial strength to do so. The myth that banks could not fail was shattered, and the convoy system of financial regulation came to an end. Forced into action by the crisis, the major financial institutions reorganized beyond traditional corporate lines, condensing into four major financial groups. The new groups also, furthermore, began reorganizing their affiliated securities companies to restrict second-tier and small to medium-sized securities companies. Amid such major changes as the shift to a registration system and the deregulation of brokerage commissions, an information technology (IT) revolution occurred. This resulted in a rush into the market of securities companies with online brokerage businesses and other new business models, producing a change in key market players.

Chart II-12. Stock Price Movement (Nikkei Dow and TOPIX) (2001–2008)



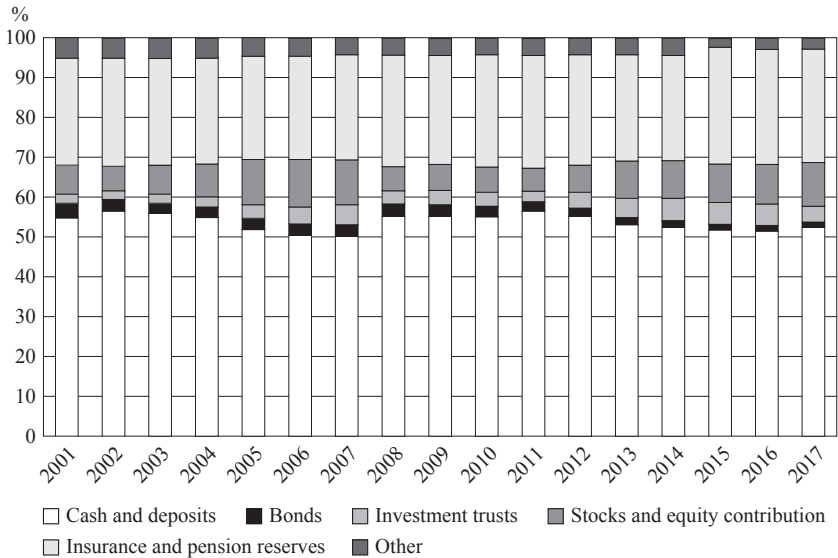
Source: Compiled from data the *Nihon Keizai Shimbun*, the *Tosho tokei geppo* (TSE Monthly Report), *Shoken tokei nenpo* (Securities Statistics Annual Report), and the web site of the Tokyo Stock Exchange.

9. Developments Since the Big Bang (2001–2008)

Entering the 2000s, the nonperforming loan problem reached a turning point. Prime Minister Junichiro Koizumi championed structural reform and oversaw the final clearing of this bad debt from the banking sector based on a Financial Revitalization Program in October 2002 that prioritized eliminating nonperforming loans. Because this approach threatened dangerously low levels of capital reserves at banks, a rise in bankruptcies in the corporate sector, and an increase in unemployment, the government took steps to control its adverse effects. It injected capital into banks to maintain the stability of the financial system and established restructuring mechanisms for corporations. These mechanisms included the enactment of the Civil Rehabilitation Act and of the function of the Resolution and Collection Corporation (RCC) and the setting up of the Industrial Revitalization Corporation of Japan (IRCJ).

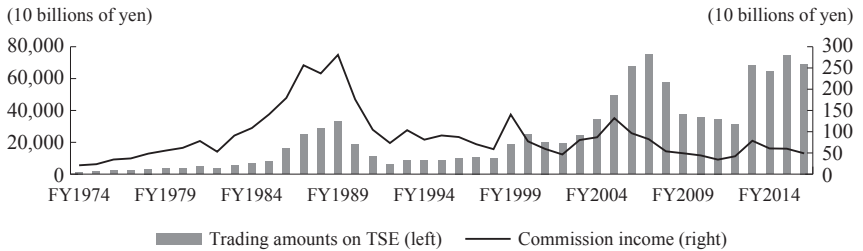
Under the slogan of “From Savings to Investment,” Japan’s government also implemented policies and programs to shift to a market-based financial system with a strongly rooted securities market at its core in which a diverse range of investors would participate. The policies and programs included the Basic Policies for Economic and Fiscal Management and Reform (June 2001), the Program for Structural Reform of Securities Markets (August

Chart II-13. Changes in the Composition of Household Assets



Source: Web site of the Bank of Japan.

Chart II-14. Trading Amounts on TSE and Brokerage Income



Source: Produced based on data from the *Tosho tokei geppo* (TSE Monthly Report), the *Tosho yoran* (TSE Fact Book), the *Shoken* and the website of the Tokyo Stock Exchange.

2001), and the Program for Promoting Securities Markets Reform (August 2002). These policies and programs put an emphasis on the expansion and improvement of sales channels (lifted a ban on banking and securities joint branch offices and introduced a securities intermediary system); the diversification of financial instruments and services (lifted a ban on wrap accounts, etc.); and the fairness and transparency of the financial business (thorough disclosure and the greater supervisory oversight of audit corporations, etc.).

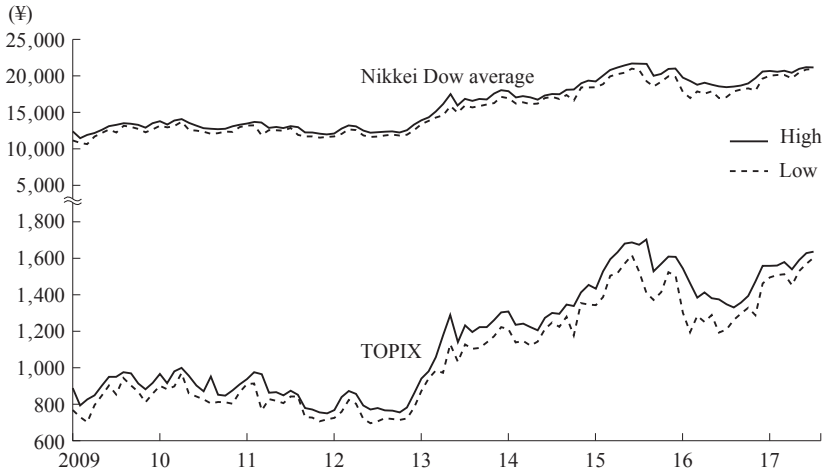
The authorities aimed at establishing a market that participants would have confidence in and that would attract a wide range of investors. Thanks to their reforms, the allocation of household financial assets into risk-class assets, such as equities, bonds, investment trusts, and other securities, trended upward until 2006. The reforms also, however, resulted in an increase in the number and volume of complex financial instruments and transactions that demanded a comprehensive set of regulations to ensure the thorough observance of investor protection rules and the coverage of an expanding and increasingly diversified range of investment instruments. In response, the government revised the Securities and Exchange Act, reintroducing it as the Financial Instruments and Exchange Act.

In the aftermath of the financial Big Bang, the retail securities business reform and the inter-market competition between exchanges got under way in earnest. In the retail securities business, ever since the liberalization of brokerage commissions, the level of commission income became sluggish. Therefore, leading securities companies that used to focus on the brokering business shifted their direction to adopting a marketing approach of paying greater attention to asset management in an effort to break away from being dependent on the market condition. Meanwhile, the inter-market competition was focused on attracting new listings and more transaction volume. The exchanges started targeting new listings around 2000, launching start-up company markets, and start-up companies and growth companies successively listed their shares on exchanges. In the battle for greater transaction volume, Tokyo Stock Exchange (TSE) quickly took the lead. The TSE introduced electronic stock trading and off-floor trading, strengthening its dominant position. The concentration of stock trading on the TSE, however, produced a notable decline in support for other regional stock exchanges, leading to successive reorganizations that began around 2000.

10. Developments after the Lehman Shock (2008 onward)

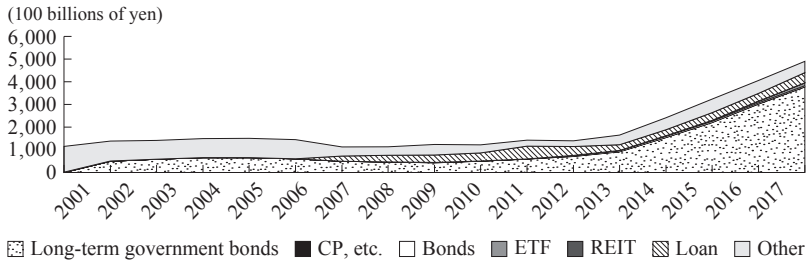
The Lehman Shock began with a liquidity crisis among European and U.S. financial institutions that resulted from a collapse in U.S. housing prices and from subprime loan defaults beginning about summer 2007. This market crisis escalated into a global financial crisis and a simultaneous recession in the global economy after Lehman Brothers Holdings filed for Chapter 11 bankruptcy protection on September 15, 2008. Then in 2009, the Greek sovereign debt problem arose. This quickly spread also through the countries which had large current account and fiscal deficits. Then financial institutions in the United Kingdom, Germany, and France became enveloped in the crisis because they held large amounts of the sovereign debt of these countries, and

Chart II-15. Stock Price Movement (Nikkei Dow and TOPIX) (2010 onward)



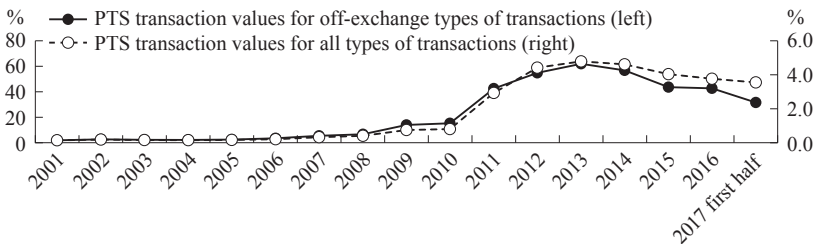
Source: Compiled from data the *Nihon Keizai Shimbun* and the web site of the Tokyo Stock Exchange.

Chart II-16. Changes in the Central Bank Assets (at the end of March)



Source: Compiled from the data published on the web site of the Bank of Japan.

Chart II-17. Transactions on Proprietary Trading Systems



Source: Produced based on information on the website of the Japan Securities Dealers Association.

thus it became a European sovereign debt crisis. Under these circumstances, each of these countries avoided a serious crisis by carrying out fiscal injections in large amounts and monetary easing. Japanese financial institutions suffered far fewer losses from the subprime loan problem, European sovereign debt crisis, and other financial shocks than those of other nations, but the financial crisis originating in the United States and Europe had its impact on the Japanese economy. In fall 2008, the Japanese stock market experienced successive sharp declines. Of the leading 10 day-to-day declines recorded in the TOPIX to July 31, 2015, the top 4 are from this period.

The Abe administration and the central bank led by Governor Kuroda are aiming to have the country break away from prolonged deflation. On the one hand, corporate governance reforms were implemented to heighten the earning capabilities of corporations, and the Corporate Governance Code and the Japanese-version Stewardship Code were introduced. On the other hand, drastic monetary easing measures were carried out. The Bank of Japan unveiled its quantitative and qualitative monetary easing policy aimed at meeting a 2% inflation target within two years and increased purchases of not only JGBs but also ETFs and REITs. As a result, the assets of the Bank of Japan increased drastically from ¥164 trillion at the end of March 2013 to ¥490 trillion at the end of March 2017. However, consumer prices did not reach the year-on-year inflation target, and the central bank adopted a negative interest rate policy effective February 2016. As such, monetary easing measures continue to be implemented on a large scale in Japan. Meanwhile, the U.S. and Europe, the forerunners in adopting monetary easing, are shifting to reducing the balance sheets of their central banks and Japan will likely be expected to specify its exit strategy.

In recent years, there has been another change in the Japanese securities market. The Tokyo Stock Exchange updated its trading system, prompting the start of inter-market competition to secure liquidity. High-frequency trading (HFT) was introduced in earnest and the use of proprietary trading systems (PTS) also increased. Inter-market competition, however, has driven up system costs of stock exchanges and called for restructuring of exchanges beyond country borders worldwide. Under these circumstances, Japan's securities market took a major step toward increasing its international competitiveness and enhancing convenience with the January 2013 merger of the Tokyo Stock Exchange and the Osaka Securities Exchange, giving birth to the Japan Exchange Group.

CHAPTER III

The Stock Primary Market

1. New Issues of Stocks in the Primary Market

For the purpose of the Companies Act, companies are classified into corporations (*kabushiki kaisha*); general partnerships (*gomei-gaisha*); limited partnerships (*goshi-gaisha*); and limited liability companies (*godo-gaisha*). Of these, corporations have a number of advantages against the others in that (1) ownership interest in a company is divided into shares of stock; (2) investors may recoup contributed capital simply by selling their shareholdings; and (3) investors shall be held liable only to the extent of capital contributed by them (limited liability). These advantages help a corporation to raise a large amount of capital from various investors.

The shares issued by a corporation are capital securities, or narrowly defined securities, in that they represent certain claims and rights of their investors. Shareholders contribute capital in exchange for their shareholdings, which give them privileges to (1) participate in the management of the corporation (by attending general shareholder meetings and exercising voting rights that are proportionate to their shareholdings); (2) claim distribution of profits; (3) claim residual corporate assets (shareholders have proportionate rights to claim residual corporate assets upon liquidation); and (4) file derivative suits. Issued shares, unlike bonds, are not redeemable except when shares are repurchased by the corporation or upon liquidation. Because contributed equity may not usually be repaid by the corporation, shareholders wishing to monetize their holdings can only do so by selling them in the market. For the benefit of increased liquidity, stock is divided into a standard unit of shares and often represented by share certificates. On the other hand, with corporate bonds, another class of capital securities, the repayment value is backed by the issuer.

The legal framework for stocks has undergone substantial changes by a series of amendments to the Commercial Code introduced since 2001. Pursuant to the amendments that took effect on October 1, 2001, par value stock was abolished and all stocks are now issued with no par value. Accordingly, the par value-based *tan'i-kabu* round-lot system was replaced by the new, discre-

Table III-1. Principal Rights of Shareholders

Rights for personal interest (rights on benefits of owing property)	Rights for common interest (rights on participating in management)
<ul style="list-style-type: none"> • Right to claim dividend of surplus • Right to subscribe for new shares • Right to demand distribution of residual assets • Right to request registration of name transfer • Right to request purchase of shares 	<ul style="list-style-type: none"> • Right to exercise votes at general shareholder meetings • Right to bring representative suit • Right to convoke a general shareholder meeting • Right to demand suspension of illegal action by a director • Right to make a shareholder proposal • Right to request dissolution • Right to demand dismissal of a corporate officer • Right to request inspection, etc.

Table III-2. Recent Amendments to the Commercial Code Relating to Equity Financing and Main Contents of the Companies Act

<p>The amendments made in 2001 (enforced on October 1, 2001):</p> <p>A revision of the system of acquiring and holding one's own shares (the ban on holding treasury shares was lifted); the abolition of the system of issuing shares with face value (under this system, all shares are issued without par value); the abolition of the requirement of net asset value (a minimum of ¥50,000 or \$487.8 at the rate of ¥102.50 to the dollar); the abolition of the <i>tan'i-kabu</i> system in favor of <i>tangen-kabu</i> system; and the relaxation of the legal reserve system, etc.</p> <p>The amendments made in 2001 (enforced on April 1, 2002):</p> <p>The institution of the equity warrant system and the abolition of regulation of the stock option system, the electrification of corporate documents, and a revision of regulation of the classified stock (the lifting on the ban of tracking stock*), etc.</p> <p>The amendments made in 2002 (enforced in April 2003):</p> <p>A revision of regulation of the classified stocks, the institution of the system relating to lapses of stock certificates, and the rationalization of the procedure for reducing capital, etc.</p> <p>The amendments made in 2003 (enforced on September 25, 2003):</p> <p>The acquisition of one's own shares by a resolution of the board of directors under the provisions of the articles of incorporation and a revision of the method of computing a limit on interim dividends, etc.</p> <p>The amendments made in 2004 (enforced on October 1, 2005):</p> <p>The adoption of a system of not issuing stock certificates, the introduction of a system of issuing notices by electronic means, etc.</p> <p>Amendments in conjunction with the enactment of the Companies Act in 2005 (enforced on May 1, 2006):</p> <p>A revision of regulations to make the share transfer system more flexible, the rationalization of the system of retiring shares, a revision of regulations relating to issuing of share certificates, and the abolition of fractional shares, etc.</p> <p>The amendments made in 2014 (enforced on May 1, 2015):</p> <p>Revision of new share issuance procedure involving transfer of controlling shareholders Introduction of a cash-out method that allows a special controlling shareholder to request other shareholders to sell their shares, etc.</p>
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Note: The ban on tracking stock (under this system, dividends are paid not out of the earnings of a company as a whole but out of the earnings of a specific division or a subsidiary of such company) was lifted.

tionary *tangen-kabu* system. Under the amendments enforced on April 1, 2002, (1) new subscription rights/warrants were introduced, (2) the regulation of stock options was relaxed, and (3) the regulation regarding multiple classified stocks was relaxed.

The Commercial Code as amended in 2004 and the Law Revising the Act on Book Entry of Corporate Bonds and Shares etc., for Streamlining Settlement of Transactions in Stocks, etc., that was promulgated in the same year introduced a system allowing electronic bookkeeping for shares, paving the way for the dematerialization of share certificates of public companies on January 5, 2009. The Companies Act that came into effect on May 1, 2006 allowed transfer restrictions on any and/or all classes of stock and issuance of classified stocks subject to wholly call. Furthermore, in the revised Companies Act enforced on May 1, 2015, the authorities introduced a “cash out” system where controlling shareholders of a company may force minority shareholders to sell their shares to them.

2. Forms of Issuing New Shares

Shares are first issued when a corporation is established. Establishment of a corporation can be roughly divided into incorporators-only establishment and by-subscription establishment. When a corporation is established only with the funds contributed to its capital stock by its promoters, this method of establishing a corporation has the advantage of its shares being fully subscribed to, but it has a drawback in that the number of shares it can issue is limited to the funds its promoters can raise. On the other hand, establishing a corporation with the capital raised by publicly offering its shares to an unspecified large number of investors is called “establishment through a public offering of shares.” While a large amount of capital can be raised through this method, one major drawback is that it takes time to successfully complete the public offering, and when its shares are not fully subscribed to by investors during the public offering period, the corporation cannot be established. Under the old provisions of the Commercial Code, the par value of shares issued by a corporation at the time it was established had to be ¥50,000 or more, but this restriction was abolished—and the requirement of par value has been liberalized—by virtue of the 2001 amendment to the Commercial Code.

Even after a corporation is established, it is a general practice for the corporation to issue new shares after in order to raise funds, to transfer the control of its management to a third party, or to enhance the liquidity of its shares. Usually, the method of issuing new shares is divided into paid-in capital increase and stock splits (and gratis issues).

Issuing new shares against the payment for them by shareholders is called

Table III-3. Forms of Issuing New Shares

Payment required
Capital increase through a public offering
Capital increase through a third-party allocation of new shares
Capital increase through a rights offering
The exercise of subscription rights/warrants
Payment not required
Stock split
Merger
Swap of shares
Stock transfers

Table III-4. Funds Raised by Equity Financing

(billions of yen)

Year	Rights offering		Public offering		Third party allotment		Exercise of subscription rights/warrants		Preferred stock and others		Total	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
1998	0	0	8	2,782	32	6,880	28	864	5	4,710	73	15,236
1999	0	0	28	3,497	75	23,473	62	2,529	25	69,894	190	99,393
2000	2	82	24	4,941	46	9,228	87	1,056	4	1,073	163	16,298
2001	3	320	18	12,015	57	4,772	85	374	5	2,161	168	19,322
2002	0	0	19	1,533	62	4,844	78	2,763	36	9,968	195	19,107
2003	2	15	35	5,672	84	2,232	121	366	74	25,322	316	33,592
2004	1	27	78	7,502	129	5,726	228	995	50	13,626	486	27,849
2005	2	37	74	6,508	150	7,781	336	1,669	45	11,678	607	27,635
2006	0	0	69	14,477	145	4,165	371	1,513	26	5,597	611	25,751
2007	1	81	60	4,570	117	6,621	347	1,650	12	7,955	537	20,796
2008	1	1	27	3,417	93	3,958	240	209	9	5,937	370	13,521
2009	0	0	52	49,668	115	7,146	169	188	28	4,740	364	61,743
2010	1	7	50	33,089	88	5,356	159	246	10	736	308	39,427
2011	0	0	45	9,678	66	3,952	171	261	7	693	289	14,584
2012	1	4	53	4,518	71	1,593	174	218	17	12,755	316	19,084
2013	1	10	114	11,137	151	3,719	350	1,904	3	1,200	619	17,970
2014	0	0	129	13,780	190	3,928	412	1,087	14	2,242	745	21,037
2015	1	1	131	9,620	187	1,636	437	815	6	7,513	762	19,585
2016	1	2	95	2,577	151	6,230	483	901	7	1,480	737	11,190
2017	2	1	116	4,242	238	8,816	526	1,926	7	613	889	15,598

Source: Website of the Tokyo Stock Exchange.

paid-in capital increase, and a corporation can raise its equity capital by this method. Paid-in capital increase is also divided on the basis of investors to whom shares are issued into public offering, rights offering, and allotment of new shares to a third party.

By definition, a stock split, the act of splitting one share into two or more shares, does not by itself increase the assets or the capital of a corporation. However, new shares issued through a stock split play an important role. The stock split increases the number of the corporation's shares outstanding on the market, and the fall in the per share price caused thereby enhances the liquidity of shares, making it easier for the corporation to raise funds through equity financing in the future. Until 2001, there was a rule banning any stock split that reduces the value of net assets per share to less than ¥50,000, but this rule was abolished by virtue of the 2001 amendment to the Commercial Code. This step was taken because of widespread complaints among venture businesses—those that have high growth potential and whose shares are traded at high prices despite limited net assets—that on account of the restrictions against a stock split, they could not improve the liquidity of their shares. However, it was desirable to prevent share certificates from being in short supply during the period from the record date of stock split (day on which the shareholders to whom new shares are allocated are determined) to the effective date (day on which the right to new shares for shareholders goes into effect), which can disrupt the demand-supply balance and cause stock prices to fluctuate violently. Hence, it was decided that the effective date would fall on the day following the record date from January 2006.

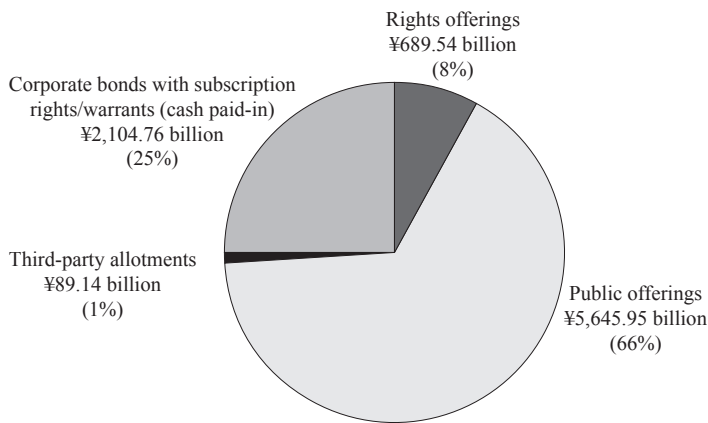
Other cases in which a corporation is authorized to issue new shares include the exercise of new share subscription rights/warrants, a new type of warrant introduced by the April 2002 amendment to the Commercial Code; equity swaps with one's subsidiaries under the equity swap system; and allocation of shares to shareholders of one's subsidiaries under the stock transfer system.

3. Procedures for Issuing New Shares

New share issuance may be done in exchange for capital paid in by investors in the form of a public offering, third-party allotment, or rights offering.

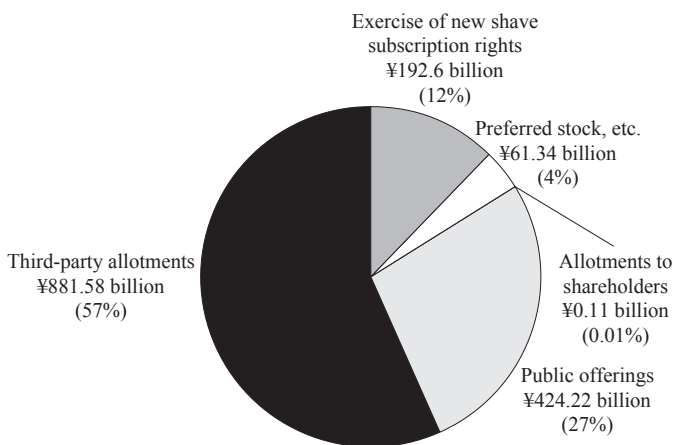
In a rights offering, shareholders on record as of a specified record date are given subscription rights in proportion to their stockholdings. In the case of public companies, grant of subscription rights or allotment of new shares to non-shareholders are only subject to board approval. On the other hand, a third-party allotment by a private company, under the Companies Act, in principle, requires a special resolution at the general shareholders meeting,

Chart III-1. Equity Financing in 1989 by TSE-Listed Companies, by Type of Financing
(Total capital procured: ¥8,529.39 billion)



Source: Tokyo Stock Exchange, *Monthly Statistics Reports*.

Chart III-2. Equity Financing in 2017 by TSE-Listed Companies, by Type of Financing
(Total capital procured: ¥1,559.84 billion)



Source: Web page of the Tokyo Stock Exchange.

but it may be conducted by ordinary resolution when provided for in the Articles of Incorporation. A rights offering to existing shareholders is a means of capital raising that is neutral to the control of corporations, in that it does not affect proportionate ownership of the shareholders. An offering of rights at par used to be the dominant measure of equity financing, but such offering is no longer common, partly due to the elimination of par value of stocks under amendments to the Commercial Code in 2001.

Public offerings grant subscription rights to the general public. A public offering raises more capital for an issuer than an offering of rights at par, which was once prevalent along with par value stock, by the excess of the issue price over par. From the viewpoint of investors, however, it deprives investors of the opportunity to earn the premium, thereby losing their incentive to subscribe. Although public offerings declined in the 1990s, they are still a primary means of raising equity capital today.

A third-party allotment raises capital by granting subscription rights to certain third parties, including banks or business corporations with special relationships with the issuer and/or its director(s). This method is often used to bail out troubled companies, strengthen relationships with corporate partners, and form a business and capital alliance rather than simply to raise capital. Of the amount raised in 2017, nearly 70% accounted for the support for individual companies. Additionally, the method has recently been noted as a measure for fending off hostile takeovers. Third-party allotments cause dilution of ownership of existing shareholders. They may be approved by board resolution except when terms of rights harm the interests of existing shareholders because they are unequivocally advantageous to the grantee(s) in which case a special resolution at the general shareholders meeting will be required (advantageous issuance). An issuer pursuing a capital increase by third party capital allocation has an obligation to explain the rationality and necessity of the capital increase in its securities registration statement.

Under the revised Companies Act that went into effect in 2015, when new share issuance by a public company involves any transfer of controlling shareholders (accounting for one-half or more of voting rights), the name and other information of the underwriter must be notified to existing shareholders. Furthermore, if there is opposition by 10% or more of voting rights, the share issuance is subject to a resolution not only by the board of directors but also by the general shareholders meeting. Thus the involvement of shareholders in share issuance was strengthened.

4. The Current State of the New Issue Market

New shares are usually issued (1) in exchange for capital contribution (equity

Table III-5. The State of Issuing New Shares by Listed Companies

Year	Paid-in capital increase	Rights offering	Public offering	Third party allotment	Preferred stock, conversion of a corporate bond with subscription rights/warrants of the convertible bond type into shares, etc.	Exercise of subscription rights/warrants	(in thousands of shares)		
							Stock split	Others	Total
1978	4,906,531	2,387,691	1,071,412	444,375	1,003,023	—	2,677,987	△154,435	7,430,084
1979	4,696,470	1,470,800	1,151,803	236,944	1,836,923	—	2,323,957	171,436	7,191,866
1980	5,900,618	1,761,008	1,619,438	311,354	2,208,818	—	2,320,677	34,846	9,206,243
1981	10,621,006	5,624,372	2,560,917	99,890	2,555,827	—	3,542,488	64,632	14,228,128
1982	4,919,006	1,932,416	1,760,389	111,822	1,102,860	11,519	4,265,996	318,347	9,503,352
1983	4,231,828	1,005,145	513,645	589,154	2,006,283	117,601	4,208,030	24,857	8,464,718
1984	5,312,713	1,170,322	778,686	319,665	2,835,670	208,370	4,033,612	169,830	9,516,159
1985	5,580,645	909,635	590,696	118,126	3,514,706	447,179	4,390,653	93,169	10,064,468
1986	4,503,842	371,191	346,883	78,308	2,831,297	876,161	3,309,802	621,924	9,065,569
1987	8,600,184	547,900	718,327	314,650	4,753,693	2,265,611	3,300,518	510,942	12,411,644
1988	12,062,096	849,464	1,286,177	169,633	4,622,233	2,123,587	4,904,200	96,212	13,152,509
1989	12,467,106	803,396	3,558,558	94,151	5,522,663	2,488,346	5,006,047	44,848	18,418,003
1990	4,733,374	758,546	1,284,250	252,593	1,859,145	578,839	8,283,600	1,632,879	14,649,854
1991	1,604,596	420,553	39,850	182,776	600,930	360,485	3,451,047	1,581,058	6,636,703
1992	766,227	244,895	2,180	190,340	139,205	189,605	1,584,040	414,121	2,764,752
1993	1,605,059	87,091	4,150	479,440	347,764	686,612	901,948	1,147,000	3,654,008
1994	1,530,474	24,152	33,360	543,846	445,479	483,635	2,330,679	1,190,447	5,051,602
1995	1,433,831	249,876	10,400	490,557	343,684	339,311	1,015,654	359,334	2,808,819
1996	2,546,611	455,200	200,883	583,427	506,753	800,348	847,835	1,873,163	5,267,610
1997	3,093,475	204,686	93,250	1,493,319	1,034,959	267,261	551,076	251,712	3,896,265
1998	3,641,490	7,707	97,337	2,380,126	1,079,024	77,295	168,262	22,696	3,832,450
1999	9,627,895	—	54,599	8,402,531	976,593	194,170	742,946	61,952	10,432,793
2000	3,709,565	87,140	84,200	2,621,987	835,744	80,492	1,158,762	1,158,762	6,467,792
2001	4,526,944	143,051	49,760	3,328,896	935,912	69,324	624,199	3,330,016	8,481,160
2002	4,260,986	—	238,268	2,719,749	546,153	756,815	692,917	1,412,881	6,366,784
2003	4,541,171	20,352	431,517	2,995,729	679,841	413,729	333,448	5,931,549	10,806,168
2004	5,659,174	18,193	516,166	1,586,466	2,404,691	1,133,656	2,975,260	24,497	8,658,931
2005	11,393,111	53,120	616,574	2,957,298	6,241,871	1,524,246	3,051,215	△13,967,015	477,311
2006	7,459,697	—	1,638,972	850,680	4,450,694	519,349	6,713,876	△1,201,938	12,971,634
2007	5,341,133	80,862	409,532	1,521,236	2,928,468	401,032	11,749,106	△3,504,021	13,586,219
2008	3,542,021	6,998	687,868	1,549,130	1,119,159	178,863	120,552	△542,754	3,119,819
2009	22,418,250	—	12,049,714	3,192,219	6,846,482	329,833	16,193,816	238,890	38,850,955
2010	10,464,418	68	7,548,008	1,935,650	835,992	144,697	877,229	△860,938	10,480,708
2011	6,391,284	—	2,947,644	2,283,962	839,211	320,465	1,842,238	625,267	8,858,789
2012	4,309,521	34,504	7,547,644	663,776	1,024,399	215,492	3,759,441	576,904	8,645,867
2013	5,226,016	613	1,244,084	2,058,111	1,400,302	522,905	27,099,251	△8,996,091	33,329,176
2014	4,624,642	—	1,422,172	627,019	1,933,058	642,391	8,841,942	△6,101,224	7,365,361
2015	3,717,412	1,560	679,898	767,728	1,933,058	470,834	7,060,155	△12,958,857	△2,181,288
2016	5,403,536	3,699	140,825	4,152,569	1,797,390	308,115	2,232,113	△29,020,941	△21,385,291
2017	4,747,915	1,312	320,095	2,934,439	606,853	885,214	4,836,899	△71,033,038	△61,448,223

Source: Tokyo Stock Exchange, *Shoken tokei nenpo* (Annual Report of Securities Statistics) and *Tosho tokei geppo* (Monthly Report of Securities Statistics).

financing in the forms of public offerings, third-party allotments, rights offerings, exercise of subscription rights, etc.); (2) in conjunction with stock splits (and gratis issues); and (3) for the purpose of corporate acquisitions. (Share counts are reduced when treasury stock is cancelled.) In 2017, the leading source of new shares issued by listed companies was by stock splits and gratis issues (increase of 4.84 billion shares), followed by equity financing (4.75 billion shares). The amendments to the Commercial Code in 1991 defined stock splits as a notion that encompasses stock dividends, gratis issues, and reclassification of paid-in capital in excess of par into capital stock all of which were cases that did not involve payments by investors at the time of issuance of new shares.

Today, in Japan, equity financing is the leading source of new shares. Listed companies on the Tokyo Stock Exchange (TSE) raised approximately ¥1.5 trillion in equity in 2017. By contrast, equity financing, except for initial public offerings, is less used in the United States and the United Kingdom because it tends to cause earnings dilution and consequently pushes down the stock price. It should be noted, however, that over the past years, equity financing in Japan has undergone many changes. During the period of rapid economic growth, corporations mostly used the method of rights offering at par to raise equity capital, because investors did not have enough accumulation of financial assets, while issuing companies suffered a chronic shortage of funds. (Stock par value was abolished in 2001.) In those days, corporations mostly relied on bank borrowings for their funding requirements, and the stock market was a marginal marketplace for raising capital. However, as the economy slowed down after the oil shocks, the funding needs of businesses were reduced, and due in part to the necessity of securing a strong stockholder base, public offerings at market price became the prevalent means of raising equity among business corporations. Meanwhile, the weight of rights offerings also shifted from rights offering based on par value to that based on a median of par and market values. In the second half of the 1980s, with progress in deregulation concerning debt financing, issuing of convertible corporate bonds and corporate bonds with subscription rights/warrants increased, and so did their conversion and exercise. Particularly, as banks came under pressure to meet Tier 1 capital requirements imposed by the Basel regulatory standards, they scrambled to shore up their capital base, and such issuing accounted for about half of equity financing at the time.

In the 1990s, there was a marked decline in capital increases by public offerings because of stagnant stock prices. At the time, new rules to ensure sound issuing of public stock offerings at market price were instituted. Among them, the Japan Securities Dealers Association (JSDA) adopted a profit distribution rule in March 1992 that required issuing companies to raise their dividend payout ratio to 30% or more and the Ministry of Finance,

which was then responsible for securities regulation, issued guidelines requiring issuing companies to meet or exceed the threshold of 10% in their return on equity (ROE) in December 1993. These rules were abolished in April 1996, and the stock primary market was fully liberalized. Increasing capital through public offerings remained stagnant thereafter. However, following the global financial crisis that kicked off in 2008, equity financing picked up as companies sought to shore up their weakened financial bases by public stock offerings which became active in 2009. Also given the surge in stock prices in 2013, stock splits reached 27.0 billion shares, the highest in history. On the other hand, the overall number of issued shares has been declining in recent years, due mainly to the retirement of treasury shares.

5. New Share Underwriting

The method of issuing shares may be divided into direct offering and indirect offering, and public offering and private placement. When the issuing company itself performs the administrative procedures necessary for issuing shares and sells them to investors, this is called “direct offering (or self-offering).” Although this method helps the issuing company save the fees payable to an intermediary, it is not an easy task to perform the technically complicated procedures and sell the securities to an unspecified large number of investors. When the issuing company commissions a specialist intermediary to handle the public offering of its shares, this is called “indirect offering.” The intermediary provides the issuing company with expert advice, handles the distribution of shares and performs the necessary administrative procedures on behalf of the issuing company, and takes over the shares remaining unsold after the public offering period. At present, almost all shares are offered through the indirect offering method. A “public offering” is the public solicitation of an unspecified large number of investors for the purchase of new shares, and “private placement” is the private solicitation of a specified small number of investors to purchase them. In public offerings of new shares, indirect offering through underwriting securities companies is the general rule.

In the case of an indirect offering, the issuing company concludes an underwriting agreement with a securities company. Underwriting agreements are divided into standby underwriting (the underwriting securities company commits itself to buying up the shares remaining unsold) and firm commitment underwriting (it agrees to buy up the entire issue from the start). Today, the latter has become the general practice.

When the total amount of shares offered is too large, a securities company alone cannot accept the underwriting risk involved. Therefore, a number of securities companies often get together to form an underwriting syndicate. Of

Table III-6. Number of Lead Managing Underwriters in Shares of Securities Companies (IPOs)

(Existing stock exchanges and start-up markets in 2017)

Securities companies	Existing Markets		Mothers		JASDAQ	
	No. of co.	% of total	No. of co.	% of total	No. of co.	% of total
Daiwa	4	26.7	10	18.5	1	7.1
Nomura	3	20.0	10	18.5	4	28.6
Mizuho	3	20.0	8	14.8	7	50.0
SMBC Nikko Securities	2	13.3	10	18.5	—	—
Tokai Tokyo	2	13.3	3	5.6	—	—
Mitsubishi UFJ Morgan Stanley	1	6.7	—	—	—	—
SBI	—	—	12	22.2	1	7.1
Others	—	—	1	1.9	1	7.1
Total	21	100.0	54	100.0	11	100.0

Source: PRONEXSUS, *Kabushiki Kokai Hakusho* (White Paper on Public Listings).

Table III-7. Flow from additional secondary distribution by over-allotment in initial public offering to syndicate cover transaction

Board of directors' meeting on issuance of new shares and secondary distribution Set OA offering limit	Determine provisional terms	BB (Report demand)	Set open price Set OA offering volume	Listing date (Trading start date)	SC transaction or GS exercise
BB = Book Building OA = Over-Allotment SC transaction = Syndicate Cover (short cover) transaction GS exercise = Exercise of Green Shoe option					
Note: SC transactions and exercise of GS must be executed within 30 days from the day following the date on which the period during which investors submit their applications to securities companies is completed (normally, 2 or 3 business days prior to the listing date).					

these securities companies, the firm that plays the leadership role in organizing the syndicate members and in negotiating the terms and conditions of the underwriting agreement with the issuing company is called the “lead managing underwriter.” And the group of securities companies that assumes no underwriting risk and only sells the securities is called the “selling group.”

In a public offering or secondary distribution, it is necessary to have a strategy for balancing supply and demand. Using an over-allotment option allows the securities firm that is the lead managing underwriter of an offering to borrow shares from existing shareholders and sell them if demand is greater than the original scheduled number of shares. In Japan, lead managing underwriters of offerings have been able to use the over-allotment option based on the underlying underwriting agreement since January 31, 2002. This option allows the sales of additional shares up to 15% of the scheduled number of shares in the public offering or secondary distribution. The short position arising when the lead managing underwriter the over-allotment option is cleared differently depending on whether the price in the secondary market has risen or fallen compared with the price after the listing. When the price of the shares has fallen, the lead managing underwriter purchases the excess shares in the secondary market (syndicate cover). When the price of the shares has risen, the lead managing underwriter exercises a green shoe option (right to acquire additional shares from the issuing company or from investors who have lent shares).

6. Private Equity Market

Public offerings and other equity financing that raise capital from the general public are mostly conducted by public companies that have their shares traded on an exchange or other public market. However, that does not mean that equity financing by private companies faces special legal restriction. In fact, equity financing regulations for private companies can be said to be less strict than those for public companies. For example, the written notice of securities does not require information concerning the operating performance or financial conditions of the issuer because, unlike the securities registration statement, it is not intended to disclose information to investors. Under the Financial Instruments and Exchange Act and Cabinet Office Order, etc. currently in force, furthermore, in cases where the proceeds from a proposed offering or secondary distribution of shares (securities) are less than ¥100 million, the private company is exempt from filing a securities registration statement, and a written notice of securities is filed in its place, regardless of whether the solicitation is extended to 50 persons or more or not. Furthermore, if the proceeds from an offering do not exceed ¥10 million or fewer than 50 persons

Table III-8. Criteria for Requirement to Submit Securities Registration Statement or Written Notice of Securities Under the Financial Instruments and Exchange Act, and Cabinet Office Order, etc.

		No. of Investors*	
		Less than 50	50 or more
Issue Amount	100 million yen or more	Not necessary	Securities Registration Statement
	10 million yen or greater but less than 100 million yen	Not necessary	Written Notice of Securities
	10 million yen or less	Not necessary	

- *Notes: 1. Under the current FIEA and Cabinet Office Order, etc. even when the number of investors solicited is less than 50, if the issuer has made an offering of the same type of security within six months previously and the combined number of investors solicited is 50 or more, the determination of whether a securities registration statement or written notice of securities is required must be made based on the total issuance amounts of the offerings.
2. In accordance with the revision of administrative orders effective April 1, 2003, issuance regulations have been liberalized as follows.
- (1) Under specified condition of the number of Qualified Institutional Investors being 250 or less, etc., the number of professional investors (Qualified Institutional Investors) may be deducted from the count of 50 or more of the number of investors being solicited.
 - (2) In determining the issuance amount for a professional investor private equity offering in a solicitation for purchase of securities where only Qualified Institutional Investors are counterparties and there is little possibility of sales to anyone other than qualified institutional investors, equities, etc. and equity related products are to be included. In this case, regardless of the number of investors, the written notice of securities is required only for issues of 100 million yen or more (for solicitations of investor groups of less than 50, please see note 1 above).

are solicited, the issuer is not, in principle, required to file a written notice of securities.

However, when viewed from the standpoint of general investors, private equity investments, given the limitations on information available to them, involve higher risks. While stock prices of public companies are properly formed through market transactions, reasonable values of private stocks are not easy to determine since there are various methods to estimate private stock prices, including the net asset method of estimating based on the company's net assets, the income method based on cash flows, and the dividend discount method based on future dividend projections. Moreover, the problem with private equity investments is that the funds invested in them are not easily recoverable due to lack of liquidity. Since it was difficult to recover funds until the company went public, investment in private equity was limited to a small number of investors, such as venture capital funds, which have

Table III-9. Examples of methods of calculating stock values of private companies

1. Net assets approach
(1) Book value method $\text{Price per share} = \text{Book value of net assets} / \text{Total number of issued shares}$ (2) Adjusted book value method $\text{Price per share} = \text{Book value of net assets reflecting unrealized gain and losses} / \text{Total number of issued shares}$ (3) Market value method $\text{Price per share} = \text{Market value of net assets} / \text{Total number of issued shares}$
2. Income approach
(1) Income capitalization method (direct return method) $\text{Price per share} = (\text{Projected future net profit after tax} / \text{Capitalization ratio}) / \text{Total number of issued shares}$ (2) DCF method $\text{Price per share} = \text{Total amount of discounted present value of projected future profit} / \text{Total number of issued shares}$
3. Dividend discount approach
(1) Dividend discount method $\text{Price per share} = (\text{Projected future annual dividends} / \text{Capitalization ratio}) / \text{Total number of issued shares}$ (2) Gordon Growth Model method $\text{Price per share} = (\text{Projected future annual dividends} / (\text{Capitalization ratio} - \text{Investment return ratio} \times \text{Retained ratio}))$

the economic wherewithal to tolerate the high risks and long investment periods associated with such investments.

In recognition of the necessity of stimulating business startups and nurturing venture-type companies, the JSDA relaxed some of its rules in June 1997, and launched a public quotation system (Green Sheet system) for private equity or unlisted shares. Securities companies became able to solicit investment in private equities for issues of OTC securities that met a certain standard of information disclosure and for which the securities companies provide publicly announced buy and sell quotes. The system also contributed to adding liquidity to unlisted shares and paving the way for companies to adopt a new means of financing before going public. In May 2015, a new shareholder community system was introduced with the purpose of dissolving the green sheet system to form a better framework by March 31, 2018 (see Chapter XI).

CHAPTER IV

The Stock Secondary Market

1. The Structure of the Stock Secondary Market

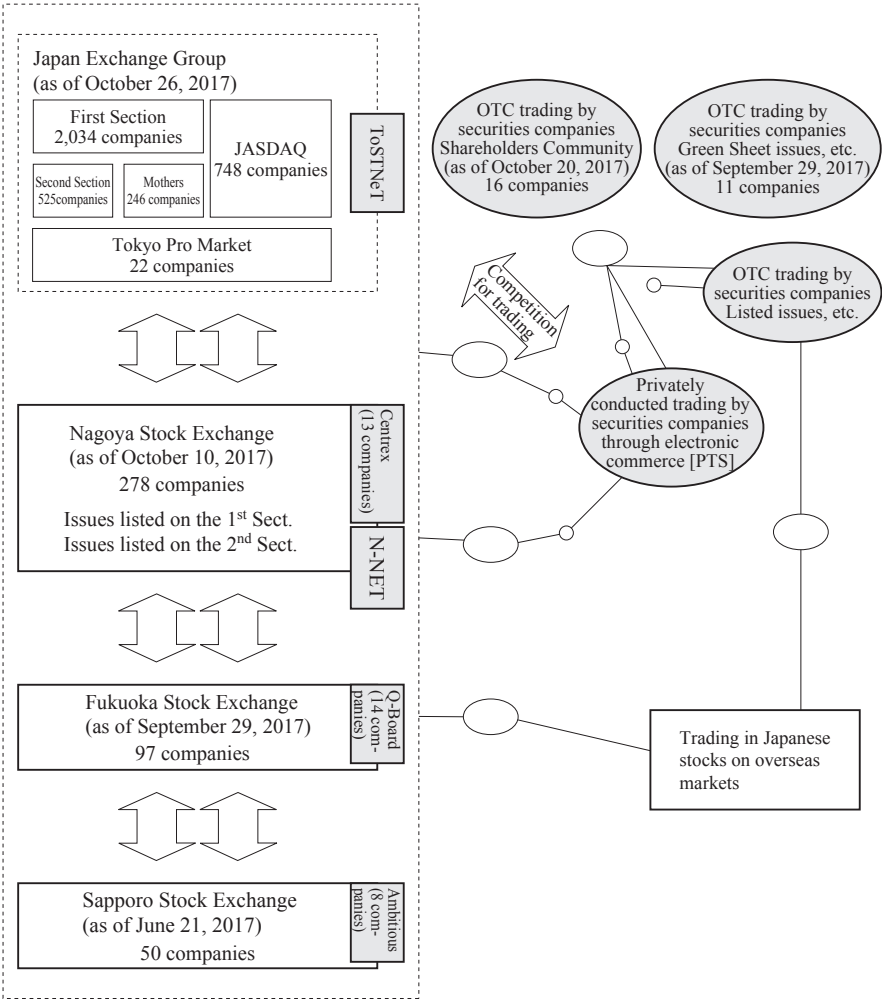
The stock secondary market on which shares are traded consists of a trading market opened on a stock exchange, a proprietary trading system (the so-called PTS) operated by private companies authorized under the 1998 amendment to the Securities and Exchange Act, and the off-exchange trading of listed stocks that was made by virtue of the same amendment, which abolished the duty to centralize securities trading on stock exchanges.

The exchange market is provided by stock exchanges, and there are four stock exchanges in Japan: the Japan Exchange Group formed from the combination of the Tokyo Stock Exchange and the Osaka Exchange, and the Nagoya, Sapporo and Fukuoka exchanges. Stock exchanges used to be membership organizations consisting of securities companies. However, under the 2000 amendment to the Securities and Exchange Act, they were authorized to change their status as corporations, and the Japan Exchange and the Nagoya Stock Exchange have become corporations.

Shares of listed stocks (1) that meet certain listing requirements are traded (2) during fixed trading hours (3) by auction, and (4) the stock exchanges as self-regulatory organizations manage and supervise the trading process and the business conduct of securities companies with a view to ensuring the fairness of trading.

In addition, there is the green sheet market where shares of companies that are not listed on a stock exchange or not registered with the over-the-counter (OTC) market are traded over the counters of securities companies and reported to the Japan Securities Dealers Association (JSDA). However, the volume of trading on the Green Sheet market is small and the market will be abolished effective March 31, 2018. Instead, a “shareholders community system” was established in May 2015 as a framework to trade unlisted stocks. The system for off-floor trading of shares listed on the Tokyo Stock Exchange (ToSTNeT) has a three-part structure to accommodate the diverse needs of investors: ToSTNeT-1 which processes large-lot and basket trades of listed stocks through negotiated or cross transactions; ToSTNeT-2 which

Chart IV-1. Inter-market Competition in Japan



concludes trades at specific prices such as the closing price several times a day; and ToSTNet-3 which handles purchases of treasury stocks. In addition, certain securities companies have opened a proprietary trading system (PTS) on their own mainly for the purpose of matching orders received after business hours.

A few years before, there were repeated cases of breakdowns of trading computer systems at securities companies and stock exchanges, erroneous

placement of orders, and other irregularities such as buy or sell orders with no intention of execution. As a result, in January 2010, the Tokyo Stock Exchange introduced its new world-class, high-speed trading system “arrow-head” to increase the credibility of the market.

2. Transaction Size of the Stock Secondary Market

As of December 31, 2016, the number of companies listed on the nation’s stock exchanges (including multiple listings) stood at 3,654, of which 3,533 were on the Tokyo Stock Exchange (TSE). The number of shares listed on the TSE came to 407.2 billion, with a total market capitalization of ¥579.6 trillion. And the value of listed shares traded on all of Japan’s stock exchanges was ¥691.3 trillion.

The level of concentration of stock trading on the Tokyo Stock Exchange is extremely high. The TSE accounts for the majority of the nation’s listed stocks, and the number of issues listed only on regional stock exchanges stood at 116. In terms of value only, the Tokyo Stock Exchange accounts for almost all of the nation’s stock trading. The heavy concentration of stock trading on the TSE may be explained by the fact that the stock markets have taken on a hierarchical structure, with the First Section of the TSE at the top, and that business corporations that are bent on enhancing their social status have sought to list their stocks on the First Section of the TSE. Therefore, blue-chip corporations have tended to converge on the First Section of the TSE. And as shares are actively traded in large volumes and on a highly liquid market, the externality of the order flow—trading flows to where shares are actively traded—was at work accelerating the concentration of orders.

The number of stocks listed on the JASDAQ market (formerly the over-the-counter market), which became a regular stock exchange in December 2004, stood at 748 at September 30, 2017, with a total market capitalization of ¥10.3 trillion, and the total trading volume during 2016 came to ¥29.7 trillion, with the value of shares traded on this market totaling ¥12.1 trillion. These figures far exceeded the Second Section of the TSE, with which the JASDAQ market has been competing for business for many years, with the exception of total market capitalization: the number of shares listed (748 vs. 523); total market capitalization (¥10.3 trillion vs. ¥10.6 trillion); total trading volume (¥29.7 trillion vs. ¥25.6 trillion); and total value of shares traded (¥12.1 trillion vs. ¥6.1 trillion).

Other emerging stock markets include the Mothers market opened on the TSE in November 1999, the NASDAQ Japan market established on the Osaka Securities Exchange in June 2000, the Centrex market of the Nagoya Stock Exchange, the Ambitious market of the Sapporo Stock Exchange, and

Table IV-1. Trading Volumes of Major Stock Exchanges

Year		2008	2009	2010	2011	2012	2013	2014	2015	2016
Trading volume (in thousands of shares)	First Section of TSE	541,576,224	552,098,670	511,695,772	524,646,368	519,754,423	841,857,965	612,851,073	620,005,885	593,610,396
	Second Section of TSE	11,775,067	10,202,351	7,315,086	9,850,350	7,703,508	22,225,351	36,199,273	36,580,825	25,604,041
	First Section of OSE	5,734,251	6,369,508	4,884,700	6,505,596	5,260,315	–	–	–	–
	Second Section of OSE	3,879,093	4,428,690	2,763,250	5,827,921	2,702,625	–	–	–	–
	JASDAQ	11,288,330	13,461,273	7,780,105	11,627,350	11,347,773	13,237,308	37,019,052	37,077,973	29,715,104

Note: The Tokyo Stock Exchange and the Osaka Securities Exchange were integrated in January 2013 and became the Japan Exchange Group as a result of which the first and the second sections of these markets were also combined.

Source: Japan Securities Dealers Association; Japan Exchange Group.

Table IV-2. Trading Volume by Stock Exchanges and Percentage Composition (2016)

Stock Exchanges	Trading Amount (millions of yen)	%
Tokyo	691,102,578	99.978
Nagoya	82,877	0.012
Fukuoka	17,209	0.002
Sapporo	51,288	0.007
Total	691,253,953	100

Source: Japan Exchange Group.

the Q-Board market of the Fukuoka Stock Exchange. Competition among the stock exchange for winning over candidates for stock listings has since become increasingly fierce. Further, in August 2007, the JASDAQ Securities Exchange joined the race with the launch of NEO, its version of a new market for venture businesses.

Subsequently, as NASDAQ of the United States withdrew from the market, NASDAQ Japan changed its name to Hercules in December 2002. And in October 2010, the Hercules, JASDAQ, and NEO markets merged to become a new JASDAQ market.

In July 2013, the cash markets of the Tokyo Stock Exchange and the Osaka Securities Exchange were integrated to form the Japan Exchange Group (JPX). As a result, Japan Exchange is now affiliated with JASDAQ, the

Mothers market and the Tokyo PRO Market.

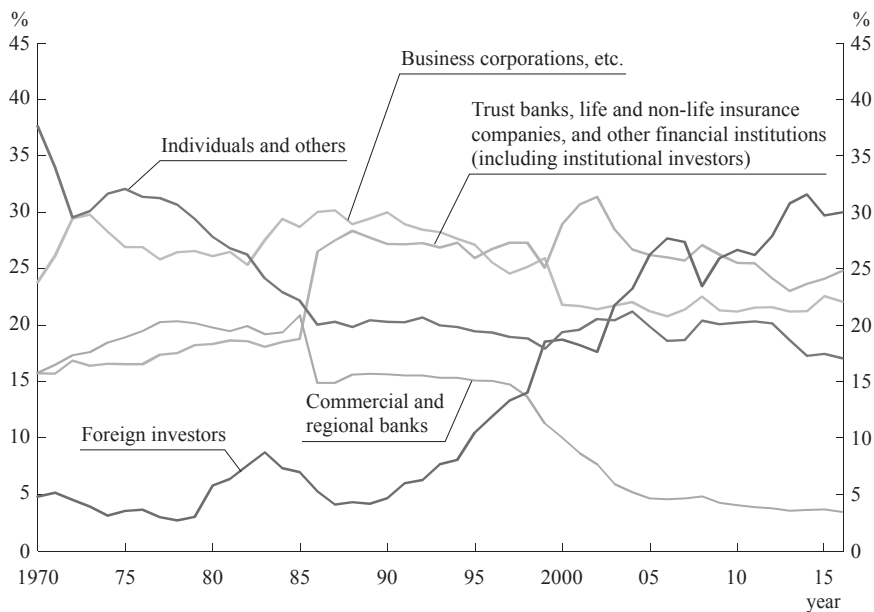
3. The Structure of Share Ownership

Following the liquidation of the financial combine *zaibatsu* (great industrial or financial conglomerates or holding companies) after the war, shares held by them were released to the stock market for distribution among individual investors. And the ratio of shares held by individual shareholders rose to 69.1% in 1949. However, as obviously not many of these individual investors could afford to hold these shares for the long haul, they liquidated their holdings soon after they had acquired them. As a result, the ratio of individual investors' shareholdings declined rapidly thereafter. Partly due to the fact that some investors had cornered these shares, groups of companies that had belonged to the former financial combine (*zaibatsu*) started cross-holding shares of one another to strengthen their group solidarity.

In the 1960s, capital transactions were liberalized following the post-war restoration efforts. However, in fear of a hostile takeover by foreign firms taking advantage of liberalized capital transactions, Japanese firms sought to build a strong shareholder base, and the ratio of the shareholdings of business corporations and financial institutions increased. Subsequently, the system of issuing shares at par value changed to one of issuing at market price, making it necessary for business corporations to maintain their share prices at a high level if only to enable them to advantageously raise funds for a capital increase. Consequently, the ratio of the shareholdings of business corporations continued to increase in the years up to 1975. Meanwhile, encouraged by the long-lasting bull market, financial institutions also continued to build their equity portfolios and increased the ratio of their stock holdings until the speculative bubble in the end of the 1980s.

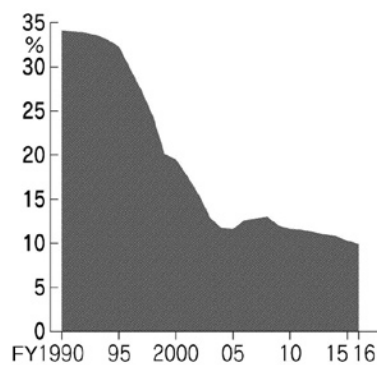
Such corporate domination of the shareholdings structure brought about a material impact on the formation of stock prices. While individuals and institutional investors bought stocks as an investment to earn yields (profit-earning securities), business corporations or financial institutions bought shares on their proprietary accounts, in many cases, for the purpose of holding shares to strengthen corporate affiliations or business tie-ups as a means of gaining control of the management. Therefore, these corporations were more determined to hold such shares for the long haul (management-stake securities) without consideration to yields on investment, and yields on such shares tended to decline. As a result, prices of such shares rose to a level that was beyond the reach of individual investors who invested in shares on the basis of the yield they produced, and the ratio of stock holdings by individual investors dropped further. In addition, as individual investors had no choice but

Chart IV-2. Changes in the Ratio of Shares Held by Different Categories of Investors



Note: Results from FY2004 to FY2009 include the portion of companies listed on JASDAQ.
Source: Share Distribution Survey.

Chart IV-3. Ratios of Cross-Shareholdings



Note: Research by Nomura Securities Co., Ltd.
Source: Nihon Keizai Shimbun; July 16, 2017

to aim at making capital gains even under such circumstances, the rate of turnover of their investments needed to be quickened. This was why individual investors took to highly speculative investment, bringing about a special structure of the stock market in this country.

However, as unrealized capital gains on stock investment shrank sharply due to falls in stock prices after the burst of the speculative bubble, holding shares was no longer an attractive investment even for corporate investors. Furthermore, stock prices dropped below their acquisition cost from the autumn of 2001, and as the system of valuing banks' shareholders at their market prices was introduced applicable to the term that ended in September 2001, banks had to deduct 60% of the unrealized losses from their earned surplus. In the 2000s, cross-shareholdings among nonfinancial companies started to rise again as defense measures against corporate takeovers and other uninvited contests for corporate control. However, with a growing interest in corporate governance, chiefly megabanks have been selling off shares in their holdings.

4. Stock Prices and Indicators for Investment (1)

Theoretical prices of assets such as land and stocks represent rents or dividends, as the case may be, capitalized by a certain rate of return of capital (interest rate plus risk premium). However, as only a small part of such assets is actually bought or sold, the total asset value is calculated by multiplying the total of such assets using the prices formed through such transactions. For instance, the total market capitalization on the First Section of the TSE as of October 30, 2017 was approximately ¥652.5 trillion, but the value of shares actually traded on that day was about ¥4.0 trillion. This indicates that the total market capitalization of the TSE is computed on the basis of share prices formed through the trading of approximately ¥4 trillion worth of shares. (Actually, it represents a sum total of the market valuation of all listed stocks, and the above explanation is intended to simplify the picture.)

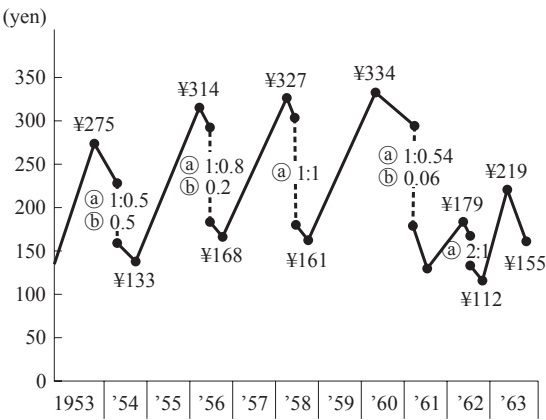
At this stage, whether the given price of a stock is high or low is judged by comparing its dividend yield with the market interest rate then prevailing. In other words, an investment opportunity to generate better-than-average earnings, working through competition among investors who seek such investment opportunities, equalizes the dividend yield on a given stock to the market rate then prevailing. However, if an oligopoly strengthens in a given industry group and the earnings gap among companies belonging to the same industry group widens, those with higher growth potential tend to reinvest a larger portion of their profit as retained earnings. (Typical of this tendency are the former IBM and Microsoft, which had no dividends until the end of

Table IV-3. Stock Splits and Changes in Divisor

Issue	Before stock split		After stock split	
	No. of shares	Stock price	No. of shares	Stock price
A	10	\$20	20	\$10
B	10	10	10	10
C	10	6	10	6
Total	30	36	40	26
Dow divisor	3		2.1667	
Dow scaled average	12		12	

Source: J. H. Lorie and M. T. Hamilton, *The Stock Market*, 1973; Japanese translation *Shoken kenkyu*, Vol. 51, 1977, pp. 73

Chart IV-4. Stock Price and Capital Increase of Toray Industries



Notes: (a) Rights offering.
(b) Free distribution of shares.

$$\text{New divisor} = \text{Previous day's divisor} \times \frac{\text{Previous day's total stock price} \pm \text{total ex rights portion}}{\text{Previous day's stock price total}}$$

$$= \text{Previous day's divisor} \times \left(1 \pm \frac{\text{Total ex rights portion}}{\text{Previous day's stock price total}} \right)$$

2002.) Under such circumstances, dividend yields cannot be computed to start with, and the level of stock prices becomes irrelevant as an indicator for investment.

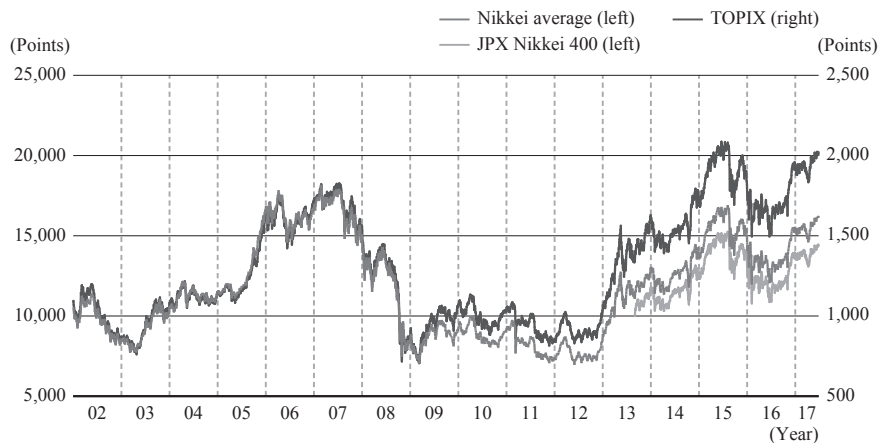
As highly profitable corporations increase their capital by reinvesting their earnings instead of issuing new shares, their per share profit increases and the price of their stock also rises proportionately thereto. If their stock price rises too high, small investors cannot buy their shares, with the result that the marketability and liquidity of their shares suffer. Therefore, such corporations seek to recover the marketability of their shares by lowering their stock prices by means of stock split-ups or stock dividends—forms of issuing new shares that do not require payment for the new shares.

If this kind of capital management policy is adopted, such practice is bound to affect the stock price indexes. Assuming that other conditions remain unchanged, a two-for-one stock split would halve the price of such shares. However, since the number of shares a shareholder of such a corporation holds would double as a result of the two-for-one split while the stock price is halved, the total market value of the shares held by such a shareholder would not change at all. The Dow scaled average represents the average of original stock prices as seen from the standpoint of shareholders prior to the stock split. The Dow Jones Industrial Average is computed by changing the divisor each time a stock price declines due to a stock split or an issuance of new shares that does not accompany payment.

5. Stock Prices and Indicators for Investment (2)

In Japan, the *Nihon Keizai Shimbun* (the *Nikkei Daily*) has devised several Dow indexes (the *Nikkei average*), typical of which is the *Nikkei 225*. This is a price-weighted equity index, which consists of 225 leading issues listed on the TSE representing various industry groups. Whenever a stock split or dividend is reported or whenever any of the 225 issues is replaced by another, DOW indexes (the *Nikkei average*) are computed using a revised divisor. The *Nikkei 225* started with a divisor of 225. Subsequently, however, the divisor has continued to decrease and dropped to 26.950 on October 30, 2017, with the result that its multiple has risen to 8.35. This means that when the simple average of the stock prices of the 225 issues rises or falls ¥20, the *Nikkei average* will increase or decrease ¥167. The Dow scaled average is designed to restore the continuity of stock prices on the basis of the total market value of original shares held by an existing investor when a stock split or an issuance of new shares that does not accompany payment is conducted. However, it actually reflects the rise or fall in the simple average of stock prices at a scale several times larger than what occurred.

Chart IV-5. Transitions in Stock Prices

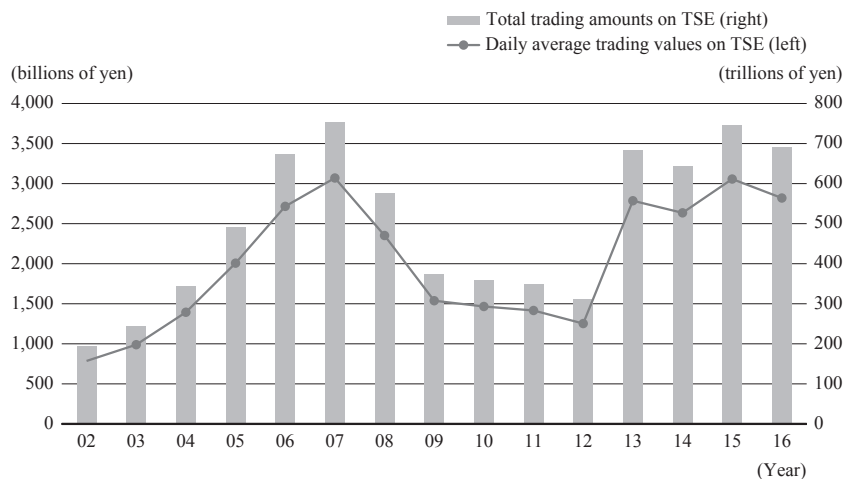


Note: The record date of JPX Nikkei 400 is August 30, 2013 (base value of 10,000 points).

Data: Bloomberg

Source: Japan Securities Dealers Association.

Chart IV-6. Amounts of Trades on the TSE



Notes: 1. Total of domestic stocks.

2. In July 2013, the cash equity market of the former Osaka Securities Exchange was integrated into the Tokyo Stock Exchange.

Source data: Japan Exchange Group.

Source: Japan Securities Dealers Association.

Acknowledging that the Nikkei average no longer reflects fairly the changed market reality brought about by the information technology (IT) boom, in April 2001 the *Nihon Keizai Shimbun* (Nikkei) replaced as many as 34 issues out of the 225 issues at a stroke. However, as the stock prices of IT-related issues fell sharply in June of the same year, the new Nikkei average dropped more sharply than the old Nikkei average would have. Furthermore, as the Nikkei average is an unweighted average computed on the basis of simple average stock price per share, it is strongly affected by a rise or fall in the prices of scarce stocks or high-priced stocks. This is why market watchers pointed out the possibility of a manipulation of the stock index when trading in the Nikkei stock index futures trading increased sharply in the first half of the 1990s.

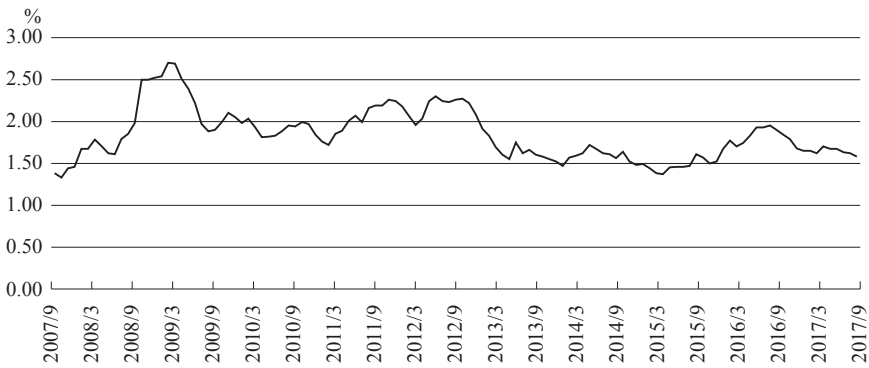
Market capitalization-weighted indexes that are designed to remedy these shortcomings of the Dow average are the New York Stock Exchange Composite Index, Standard & Poor's (S&P) 500 index, and the TOPIX (Tokyo Stock Price Index). TOPIX represents the total market capitalization of all issues listed on the First Section of the TSE computed based on the assumption that market capitalization as of the base date (January 4, 1968) is 100.

TOPIX has the following characteristics: (1) it covers all issues listed on the First Section of the TSE and therefore has become an index that reflects changes occurring in the country's industrial structures and stock price trends, and it is an index which can avert the discontinuity that might occur when its component issues are replaced by others; (2) it allows one to easily determine changes in market size from the perspective of market capitalization; and (3) it is weighted by the number of shares of listed issues and therefore is relatively immune to a rise or fall in the prices of scarce stocks or high-priced stocks. Since January 6, 2014, the Japan Exchange Group has been announcing the JPX-NIKKEI 400 Index, which is composed of companies that meet requirements of global investment standards, such as efficient use of capital and investor-focused management perspectives.

6. Stock Prices and Indicators for Investment (3)

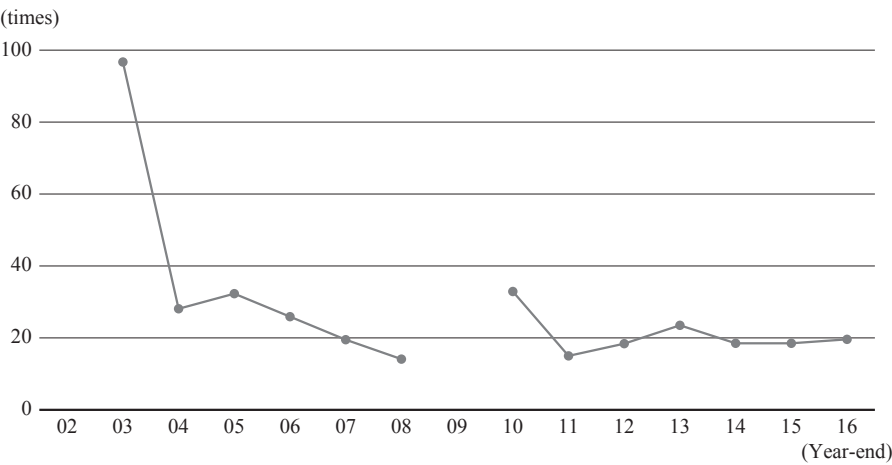
As room for the discretionary implementation of capital management policy grew and diversified, the weight carried by capital gains in determining an investment policy increased and the importance of dividends or return on investment as an indicator for investment decreased. Consequently, the comprehensive yield that adds dividends to capital gains has come to be adopted as an index. In addition, a growing number of investors have come to value the price earnings ratio (PER), which is the quotient of the per share stock price divided by profit, i.e., a reciprocal of return on investment.

Chart IV-7. Dividend Yields of TSE First Section Companies



Source: Japan Exchange Group.

Chart IV-8. Transition in Average PER (simple average) of Stocks on the TSE First Section



Note: End of 2002 and 2009 are blank, since the total net profit after tax per share was a negative figure.

Source data: Japan Exchange Group.

Source: Japan Securities Dealers Association.

The reason behind the growing popularity of PER as an index for investment was the concept of “growth stocks.” In other words, as these corporations with high growth potential continued to follow financial policies that valued retained earnings and reinvestment of profit, dividend yield (a traditional index for investment) decreased, making it difficult for brokerage firms to put out buy recommendations on such shares. A phenomenon representative of this was what was known as the yield revolution—in which dividend yield fell below bond yield—that occurred in the United States in 1958. In Japan, also, a similar situation occurred in the 1960s.

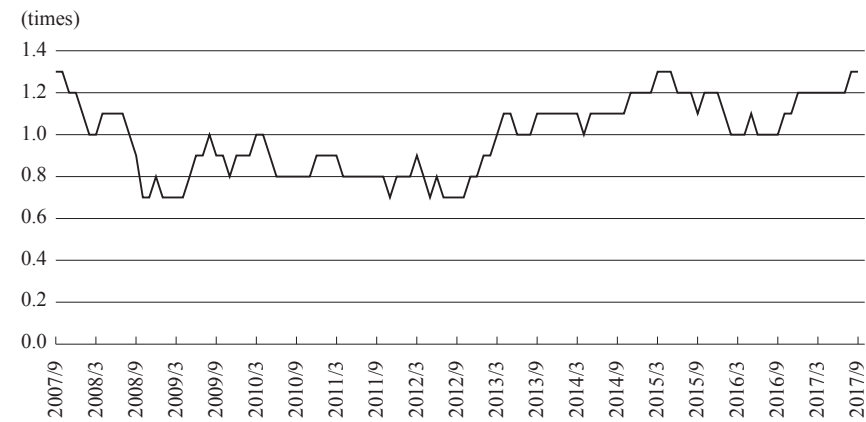
In such a situation, there was a need to link the growth potential of a corporation to the level of its stock price one way or another in order for brokerage firms to put out buy recommendations on such shares, and the answer was the PER. In other words, the PER shows multiples of earnings at which the underlying shares are bought and sold. Therefore, when the shares of a corporation have a high PER, it means that the market believes that the corporation has high growth potential. Actually, securities companies compare the PER of an issue with the industry average or with other issues in the same industry group to measure whether the issue is overvalued or undervalued. What is more, the PER is used not only as a stock price index of individual issues but also as a measure to compare the stock price level of a country with the levels of other countries. Today, it has thus become one of the typical stock price indexes.

However, while stock yield can be compared with an objective index, such as market interest rate, the PER has a drawback in that it can be compared with other indicators only relatively. For instance, as is often pointed out, the PER of the S&P 500, one of the major stock indexes of the United States, has moved between 15 and 30 since the war, but the Nikkei 225 of Japan has risen as high as 80 or more in the past. (On October 30, 2017, the unconsolidated PER of the TSE First Section stood at 18.0.) It has been analyzed that the difference between the levels of the PERs of the two countries was attributable to the difference in the business accounting system (notably, the method of depreciation) and the cross-shareholding system of Japan. It is possible that these factors affected the PER level of Japan. More importantly, however, was the fact that there was no valid PER level to start with.

7. Stock Prices and Indicators for Investment (4)

While the PER shows the relationship between per share earnings and stock prices, earnings vary depending on the method used to calculate them. Particularly, depreciation expenses associated with capital investments are deducted from taxable income (which, therefore, cuts into earnings), but such

Chart IV-9. PBRs of TSE First Section Companies



Source: Japan Exchange Group.

$$\text{PER} = \frac{\text{Stock price}}{\text{Per share after-tax income}}$$

$$\text{PBR} = \frac{\text{Stock price}}{\text{Per share net asset value}}$$

$$\text{PCFR} = \frac{\text{Stock price}}{\text{After-tax income} + \text{depreciation charges} - (\text{dividend} + \text{officers' bonus})}$$

investments contribute significantly to future earnings. Therefore, a stock price index based on earnings could sometimes mislead investors when they make an investment decision.

The price cash flow ratio (PCFR) is an index designed to reflect the growth potential of a corporation based on its share price. The PCFR is computed by dividing the stock price by the sum of the after-tax income and depreciation expenses for the term, minus any dividends and executive officers' bonuses. Since depreciation expenses are retained and reinvested at a later date, they are an important factor to take into account when assessing the growth potential of a corporation, as they indicate its real earnings and cash flow.

The PCFR is generally used in comparing the stock price of a corporation with the stock prices of other corporations in the same industry group and particularly in evaluating the stock prices of high-tech corporations whose future competitiveness is largely determined by the scale and components of their capital investment.

Another frequently used index for investment is the price book value ratio (PBR), which shows the relationship between the net asset value owned by a

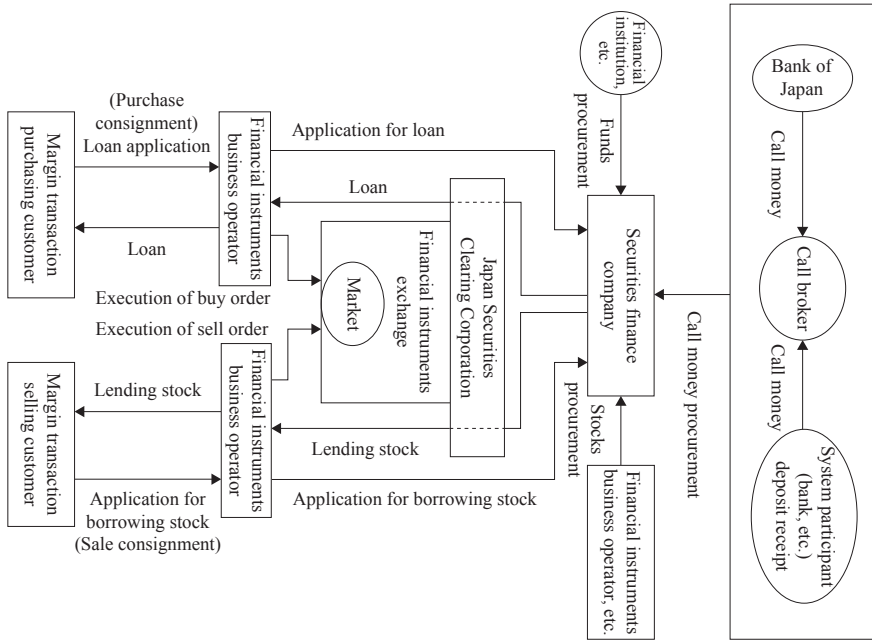
corporation and its stock price. The PBR of a corporation is computed by dividing its stock price by the value of net assets per share. The net assets of a corporation represent the sum of the capital and earned surplus, etc., which is called equity capital, and they are computed by deducting liabilities (debt, etc.) from the total assets listed on the debit side of the balance sheet. In other words, it is the net assets that would remain after repaying all the debts of a corporation out of the proceeds of its assets when the corporation is dissolved at a certain point in time. Hence, the PBR is an index that compares the stock price of a corporation prevailing at a given time with its liquidation net asset value per share. If the PBR of any corporation falls below one (or below its liquidation net asset value per share), the stock price of such a corporation is often considered undervalued.

It is to be noted, however, that the use of the PBR as an index for investment is based on the assumption that it reflects the actual book value of the issue. If the actual asset value of the land and shareholdings of a corporation falls below the book value of the land and shareholdings on account of an unrealized loss, the stock price of such issue, even when its PBR is below one, cannot be considered undervalued. If such a situation arises, and the stock market functions efficiently to a certain degree, corporations will likely seek actively to merge with or acquire (M&A) another corporation. In fact, a string of corporate mergers and acquisitions did take place on the U.S. stock markets when Tobin's q (a modified version of the PBR) fell below one. The PBR of the First Section of the TSE stood at 1.41 on October 30, 2017.

8. The Margin Trading System (1)

Shinyo torihiki (margin trading) is a system crafted on the model of the margin trading conducted in the United States and was introduced into Japan in June 1951 with a view to stimulating speculative demand for securities trading. Margin trading is a transaction in which an investor can buy a certain number of shares of a stock or sell shares which it does not own, with funds or shares borrowed from a Financial Instruments Business Operator (securities company) by depositing a margin with the Financial Instruments Business Operator. On the other hand, the Financial Instruments Business Operator that receives such an order must settle the transaction on the fourth business day from the date of such transaction. As there was no adequate stock lending market or securities financing market in Japan in the early days, a securities finance company was created to help Financial Instruments Business Operators reduce their burden of having to provide cash or stock certificates for the settlement of such margin trading. This is called the Loans for Margin Transactions.

Chart IV-10. Outline of Margin Trading and Loans for Margin Transactions



- ① Standardized margin trading (between a customer and a Financial Instruments Business Operator)
 - Collateral: Shares bought (or the proceeds from the sale of shares sold)
 - Margin: 30% or more of the market price of the shares bought (or sold) on margin. (When a substitute security is deposited, such security will have a collateral value of up to 80% or less of its market price.) However, the minimum amount of the margin in all cases is ¥300,000.
- ② Loans for margin transactions (between a Financial Instruments Business Operator and a securities finance company)
 - Collateral: Shares bought (or the proceeds from the sale of shares sold)
 - Guarantee deposit: 30% or more of loan balance (or the lending stock balance) (When a substitute security is deposited, such security will have a collateral value of up to 80% of its market price.)
- ③ Call money share collateral deposit receipt system (participating in the system are securities finance companies, call money dealers, companies affiliated with the deposit receipt system, financial instruments exchanges, and the Bank of Japan).

Under this system, stock certificates pledged as collateral for a loan for margin transaction received by a securities finance company (only such issues recognized as appropriate by the Bank of Japan) are transferred to the account of a financial instruments exchange opened with the Japan Securities Depository Center and the securities finance company takes in call money by pledging as collateral the deposit receipt issued by the financial instruments exchange based on the aforesaid stock certificates. This deposit receipt also serves as collateral security when a call money dealer borrows funds from the Bank of Japan. In other words, a system is in place to have the funds necessary for the loan transaction to be provided by the Bank of Japan to a securities finance company through a call money dealer with stock certificates as substantial collateral security.

Note: The margin rate and the ratio of collateral value above may change based on margin trading regulations.

The loan for margin transaction is where a securities finance company lends a Financial Instruments Business Operator, who is a participant of a financial instruments exchange, funds or stock certificates that are associated with margin trading issues and that are needed to settle a margin transaction, through the settlement organization of the financial instruments exchange. The securities finance company can save costs and expenses by internally offsetting applications for a loan of shares of a certain stock against those for lending shares of the same stock—more specifically, by lending the money it collects from a margin selling investor (or stock certificates it collects as collateral from a margin buying investor). When a shortage of funds develops after offsetting, the securities finance company meets the shortage by borrowing the amount of such shortage from a bank, the call market, or the Bank of Japan. When a shortage of stock certificates develops after offsetting, the securities finance company may borrow them by inviting bids from Financial Instruments Business Operators and institutional investors (see the chart on the next page). Issues for margin trading purposes are selected from among listed stocks based on standards set by the financial instruments exchange. Stocks that can be margin traded or lent for margin trading purposes can be categorized into trading issues, which can be used for both trading and loans, and loanable issues, which are used only for loans. Loanable issues are selected from the perspective of ensuring liquidity to handle speculative demand based on the number of tradable shares or the number of shareholders. Moreover, there are added restrictions on the amounts of stocks that can be borrowed.

The securities finance companies are special financial institutions on the securities market established in February 1950. They began operating loan transactions in line with the introduction of the margin trading system in June 1951. Since the role of securities finance companies on the securities market increased thereon as margin trading expanded, to strengthen their function, the government introduced a licensing system in April 1956, requiring securities finance companies to be authorized by the Minister of Finance (currently, the Prime Minister). Since then, there has been significant consolidation among securities finance companies that had been established on regional stock exchanges. As of September 30, 2017, Japan Securities Finance (JSF) alone handles loans for margin transactions as designated by each of the stock exchanges in Tokyo, Nagoya, Sapporo and Osaka.

9. The Margin Trading System (2)

Based on the amendments to the Securities and Exchange Act in 1998, the restrictions on Financial Instruments Business Operators borrowing stock

Table IV-4. Comparison of Standardized and Negotiable Margin Trading

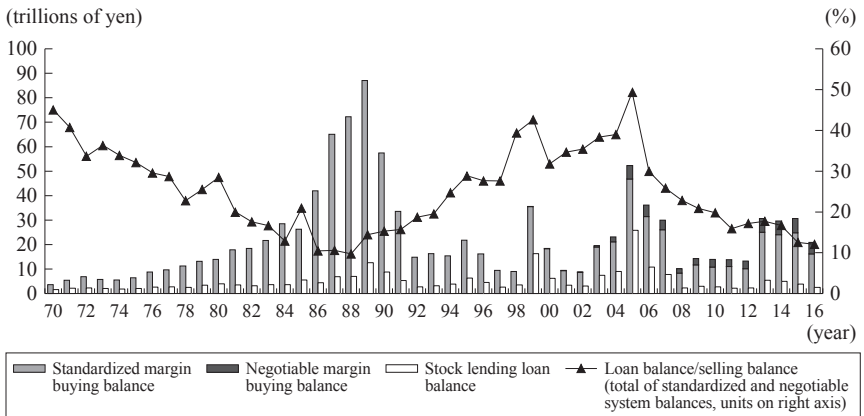
	Standardized margin trading	Negotiable margin trading
Margin deposit	30% or more of trade contract value	30% or more of trade contract value
Loan rate (negative interest)	Rate set by the financial instruments exchange	Determined between the investor and the Financial Instruments Business Operator
Repayment due date	Up to six months	Determined between the investor and the Financial Instruments Business Operator
Eligible issues	Issues selected by the financial instruments exchange	In principle, all listed stocks
Rights processing	Method set by the financial instruments exchange	Determined between the investor and the Financial Instruments Business Operator
Financing (loan transaction)	Available	Not available

Source: Compiled using data from the website of the Japan Exchange Group, etc.

without going through securities finance companies and on borrowing and lending stock between themselves (the so-called stock lending market) were lifted. At the same time, the regulator approved negotiable margin trading, allowing Financial Instruments Business Operators to freely determine prices, interest rates, and contract terms between themselves and their customers. At this juncture, those margin tradings backing loans for margin transactions for which the financial instruments exchanges determine prices, interest rates, and contract terms on their markets came to be called standardized margin transactions (see Table IV-4). Negotiable margin trading became increasingly popular after they started to be used in Internet trading in Japan in 2003, and such transactions have come to account for about 20% of all margin purchase balances in recent years.

Looking at the proportion of loan balances in margin stock buying balances, the dependency of Financial Instruments Business Operators on loans for margin transactions almost uniformly declined up to 1988 because of their growing ability to finance themselves primarily out of their internal reserves. However, the market's dependency on loans for margin transactions began to rise again in the 1990s, due to factors including the deterioration in the financial positions of Financial Instruments Business Operators following the burst of the economic bubble, the emergence of Internet trading, and a recovery in stock market prices starting in 1999. In 2005, the dependency of Financial Instruments Business Operators on loans for margin transactions neared the 50% mark. Since then, the dependency on loans for margin trans-

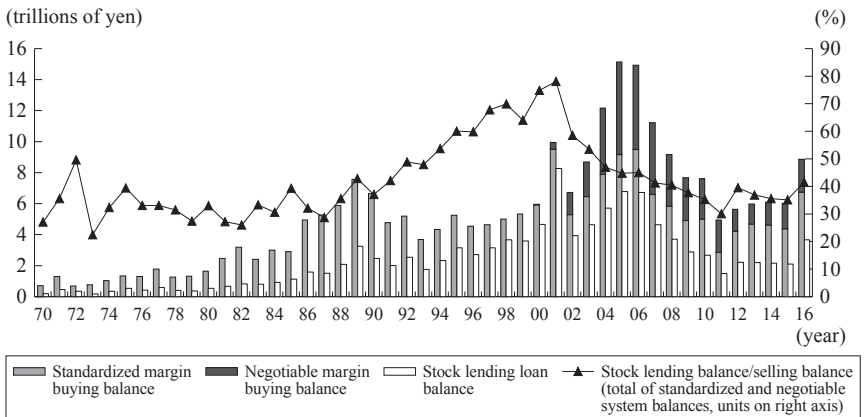
Chart IV-11. Margin Buying Balances (standardized and negotiable trading) and Loan/Selling Balances



Note: Previous to 2012, figures included the margin balances of companies listed on the Osaka Securities Exchange.

Source: Compiled using data from the website of the Japan Exchange Group, etc.

Chart IV-12. Margin Selling Balances (standardized and negotiable trading) and Loan/Stock Lending Balances



Note: Previous to 2012, figures included the margin balances of companies listed on the Osaka Securities Exchange.

Source: Compiled using data from the website of the Japan Exchange Group, etc.

actions has taken a downward path because of the greater diversification of financing sources for Financial Instruments Business Operators. On the other hand, looking at the balance of shares used in lending transactions, the traditionally small amount of margin sales began to rise in the latter half of the 1990s as institutionalization of stock markets became active and cases of Financial Instruments Business Operators borrowing shares from securities finance companies on their own proprietary accounts to settle buy orders increased. By 2000, the dependency of Financial Instruments Business Operators on loans for margin transactions had risen to 70%. Since then, this dependency has continued to fall because of the expanding number of sources of stock lending following the lifting of restrictions on the stock lending market.

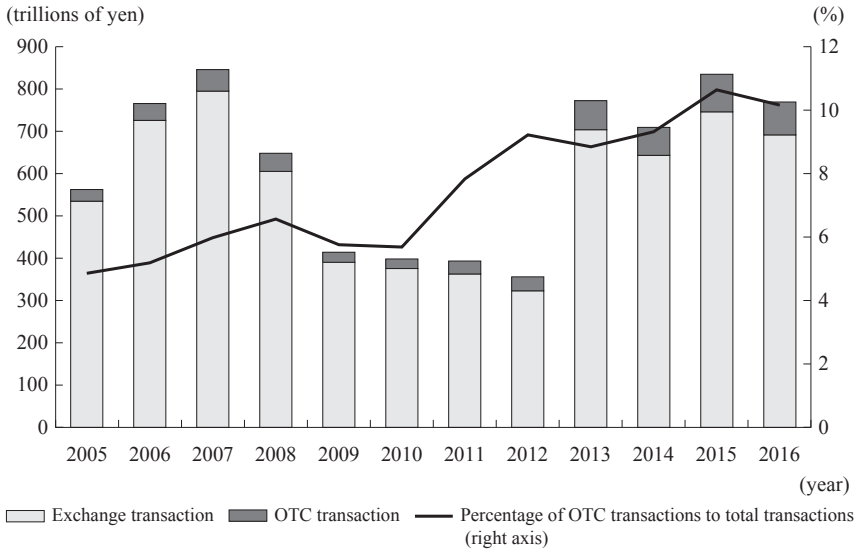
The margin trading system and margin deposit operations of securities finance companies have changed and diversified along with the development of the securities market in Japan. The margin trading system was revised frequently to expand the number of available issues as a measure to invigorate the market, with the Second Section issues being added in December 1991 and the OTC introducing a margin trading system in October 1997. Margin deposit operations have changed as well. A financing system using loanable issues for margin transactions for non-loanable issues was introduced in October 1995, and loans for margin transactions became available for the JAS-DAQ market in April 2004. Furthermore, a commercial financing system became available for Financial Instruments Business Operators that needed cash to settle their margin buying trades in negotiable margin transactions.

In addition to their licensed-based loans for margin transactions business, securities finance companies also (1) offer collateral loans for bonds and general collateral loans to Financial Instruments Business Operators or their clients, (2) run a commercial stock lending business other than the loans for margin transactions for financial instruments companies, and (3) act as intermediates in bond lending transactions.

10. Diversification of the Securities Trading System

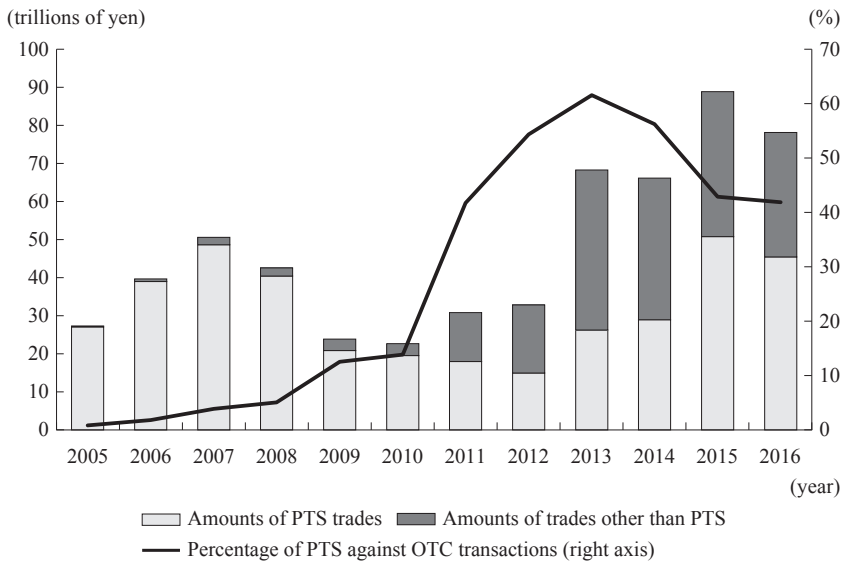
The basic function of the stock market is to efficiently allocate funds by finding a price at which all demands are matched with the supply available. At a stage when information technology (IT) was not fully developed, there was a need to concentrate securities trading in one place in order to achieve that purpose. In fact, a number of stock exchanges had been established in different regions to the extent that transactions in each region could be concentrated at the respective exchange, and listed securities were required to be traded on these stock exchanges. In an environment where dissemination of infor-

Chart IV-13. Trading Amounts of Exchange Transactions and OTC Transactions



Source: Japan Securities Dealers Association.

Chart IV-14. Breakdowns of OTC transactions



Source: Japan Securities Dealers Association.

mation, communication of orders, and processing of transactions incur costs and cannot be conducted in a timely manner, no arbitrage transaction—a practice that plays the role of eliminating a price difference—could sufficiently take place even if an opportunity arose to make a profit by taking advantage of a difference in the price of one and the same stock between stock exchanges. Under such circumstances, it became necessary to concentrate securities trading on the stock exchange to avert the occurrence of what is known as the “fragmentation of the market.”

However, the securities markets have shifted to computerized trading systems thanks to the development of information technology, and stock exchanges where orders are processed manually on the trading floor have become a rarity in the world. That is, elements of securities trading, i.e. integration of trading information, transmission and execution of orders, delivery of securities, settlement, and custody, are integrated by the computer networks and processed in real time, realizing an environment in which balanced prices can be found even through a dispersed computer network installed at markets in multiple locations. The idea of market operation based on such an infrastructure of securities trading is called inter-market competition. Meanwhile, given the growing number of institutional investors in the securities market, the need for a guarantee of anonymity and for a trading system designed to minimize the market impact cost has increased, and special forms of trading, such as large-lot transactions and basket transactions, have also increased. As complex trading rules can be instituted without difficulty in a computerized trading system, a trading system capable of meeting such needs can be provided at a low cost.

These technological innovations make it difficult to distinguish the trading systems provided by private companies from those provided by the traditional securities exchanges. In the United States, the Securities and Exchange Commission (SEC) has acknowledged the similarity of functions performed by the two types of trading systems and has adopted the Alternative Trading System (ATS) and has authorized the Electronic Communication Network (ECN), a type of ATS, as a securities exchange. Also in Japan, the regulators have authorized negotiated trading in listed securities following the lifting of the ban against off-exchange securities trading and have added a Proprietary Trading System (PTS) to the types of securities business that can be handled by securities companies.

CHAPTER V

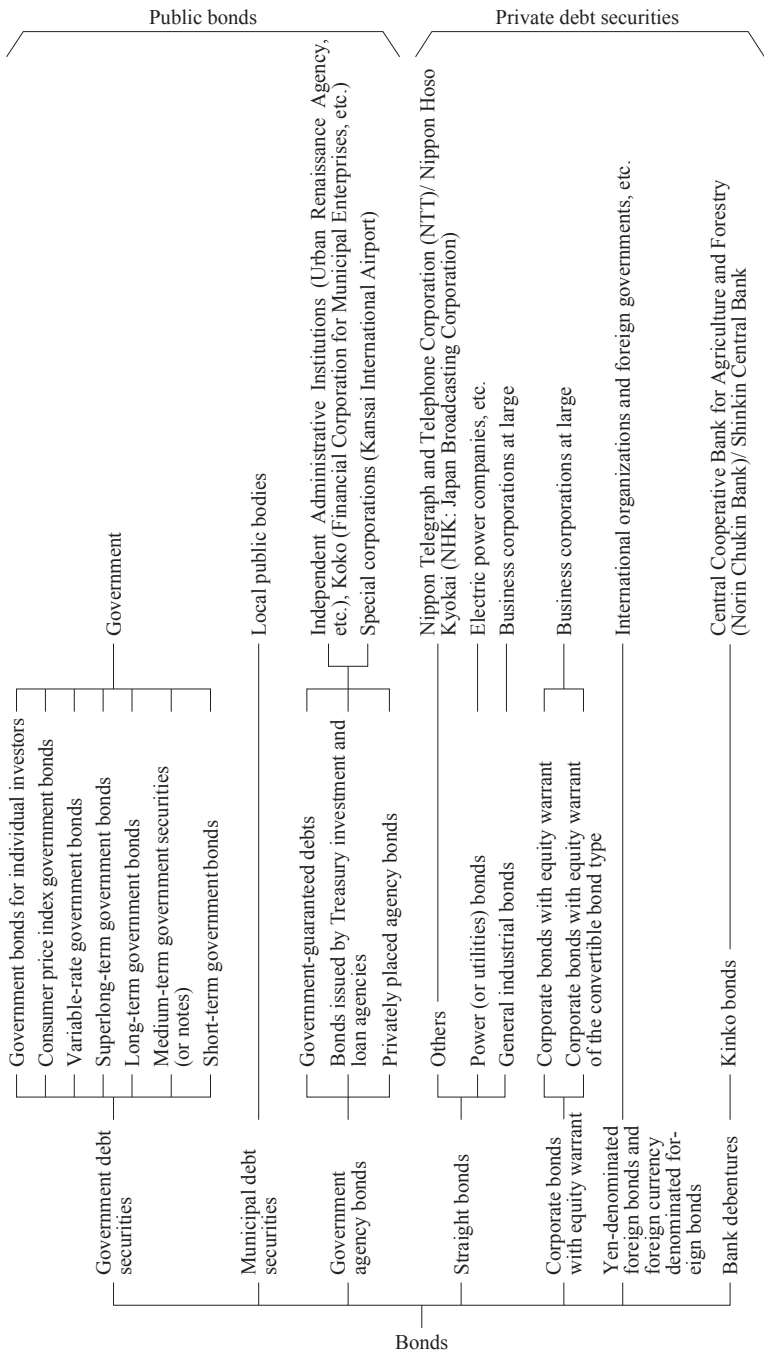
New Issues of Bonds in the Primary Market

1. Types of Bonds

The term “bonds” generally refers to debt securities issued by governments and other public entities as well as by private companies. The issuance of bonds is a means of direct financing, through which the issuer raises funds, but, unlike equity financing, the issuer has an obligation to repay the principal at maturity. Bonds are classified by type of issuer into government debt securities, municipal debt securities, government agency bonds, bank debentures, corporate bonds (industrial bonds), and foreign bonds.

Government debt securities are those issued by the national government, and they are classified as short-term bills (maturing in one year or less), medium-term notes (maturing in two to five years), long-term bonds (maturing in six to ten years), or superlong-term bonds (maturing in ten years or more) to distinguish an issue’s term to maturity. In fiscal 2002 (ended on March 31, 2003), the government introduced the STRIPS and (variable-rate) retail ten-year Japanese government bond (JGB) programs. Under the former program, the principal and individual interest payment components of JGBs designated by the Ministry of Finance as STRIPS bonds may be traded as separate zero-coupon government bonds (all fixed-rate JGBs issued on and after January 27, 2003 are eligible for the program). Subsequently, the government started issuing ten-year CPI (consumer price index)-linked bonds, five-year bonds for retail investors, forty-year fixed-rate bonds, and three-year bonds for retail investors in fiscal 2003, 2005, 2007, and 2010 respectively. Municipal debt securities can be roughly divided by type of funds into “public sector funds” and “private sector funds.” The former are raised through fiscal loan funds and Japan Finance Organization for Municipalities, while the latter are raised in the public market or underwritten by banks and other financial institutions. Among these funds, the funds raised in public markets are divided into nationally placed municipal bonds, jointly offered local government bonds, and municipal bonds targeting local residents (mini-local bonds). While the municipal bonds underwritten by banks and other financial institutions are called bank, etc. underwritten bonds, they come in two types, funds

Chart V-1. Types of Bonds



Note: Local government bonds represent debt issued under local government laws and fiscal policies. However, only those publicly placed or underwritten by banks or other financial institutions based on the issue of debt securities are included in public bonds.

borrowed on deeds from banks and other financial institutions or debt securities issued in the market. Government agency bonds are debt securities issued by various government-affiliated entities, such as independent administrative agencies. Agency issues with a government guarantee are categorized as government-guaranteed bonds. On the other hand, non-guaranteed government agency bonds can be further divided into Fiscal Investment and Loan Program (FILP) agency bonds that are publicly placed bonds and privately placed bonds issued by certain special financial institutions. The three categories of debt securities mentioned above are sometimes collectively called “public bonds.” Bank debentures are debt securities issued by certain banking institutions under special laws. They are principally issued in the form and maturities of five-year interest-bearing and one-year discount debentures. In addition, as bank debentures and government agency bonds fall within the category of “debentures issued by a juridical person under a special Act” stipulated in Article 2, Paragraph 1, Item (iii) of the Financial Instruments and Exchange Act, they are sometimes called “special debts (*tokushusai*).” Corporate bonds are those issued by private-sector companies and are also known as industrial bonds. In addition to nonfinancial enterprises, banks and consumer finance companies may also issue corporate bonds. Foreign bonds are defined as debt securities issued in Japan by non-Japanese governments or corporations. Those denominated in yen, in particular, are separately classified as yen-denominated foreign bonds.

2. Issuing Status of Bonds

The total value of public and corporate bonds issued in fiscal 2016 decreased approximately 1.5% from the previous year to ¥197.2 trillion. The breakdown of issuance is described below. Of this amount, ¥168.0 trillion, or roughly 85% of the total value, was accounted for by government bonds, underscoring their dominant presence in the public and corporate bond market in Japan. Up until fiscal 2008, JGB issuance had been on a decline along with the upswing in the central government’s financial position, but given the deterioration in the government’s finances caused by the slump in the economy following the Lehman Shock in September 2008, it has been on the upswing since fiscal 2009. JGB issuance can be broken down into superlong-term government bonds (¥33.0 trillion); long-term government bonds (¥35.2 trillion); medium-term government notes (¥60.5 trillion); treasury bills (¥25.0 trillion), and bonds for retail investors (¥4.6 trillion).

In fiscal 2016, ¥6.2 trillion worth of municipal bonds were publicly offered. The volume of issuance continues to be at a high level although it has been on a slight decline since fiscal 2013. The continuing high level is basi-

Table V-1. The Value of Bonds Issued

(¥100 million)

FY	Total of public bonds publicly offered		Government bonds		Government securities sold on the market		Superlong-term government bonds		Long-term government bonds		Inflation-indexed government bonds	
	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount
2015	764	1,880,765	78	1,736,700	78	1,632,759	9	347,870	4	355,190	1	21,394
2016	701	1,822,141	78	1,680,014	78	1,600,274	9	330,399	4	351,724	1	17,272

FY	Medium term government bonds (5 year)		Medium term government bonds (4, 2 year)		Individual investor government bonds		Short-term discount government bonds		Bonds subscribed to by the Bank of Japan	
	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount
2015	4	321,281	12	307,657	36	21,367	12	258,000	—	103,941
2016	4	308,782	12	296,542	36	45,556	12	250,000	—	79,740

FY	Municipal bonds		Government-guaranteed bonds		FILP agency bonds	
	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount
2015	406	67,716	68	31,456	212	44,893
2016	360	62,493	79	31,069	184	48,565

FY	Total of private bonds publicly offered		Straight bonds		Asset backed corporate bonds		Corporate bonds with convertible-bond-type subscription rights/warrants	
	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount
2015	353	71,572	348	69,412	1	500	4	1,660
2016	553	115,679	546	114,129	2	1,000	5	550

FY	Bank debentures		Discount bank debentures		Interest-bearing bank debentures	
	No. of issues	Issue Amount	No. of issues	Issue Amount	No. of issues	Issue Amount
2015	91	23,647	0	0	91	23,647
2016	76	17,380	0	0	76	17,380

FY	Nonresident bonds (yen denominated)		Yen-denominated foreign bonds	
	No. of issues	Issue Amount	No. of issues	Issue Amount
2015	72	18,159	72	18,159
2016	47	16,220	47	16,220

FY	Total of bonds	
	No. of issues	Issue Amount
2015	1,280	1,994,143
2016	1,377	1,971,419

Notes: 1. Amounts are in hundreds of million yen and decimal points have been rounded off.

2. The total of bonds is the aggregate of public bonds publicly offered, private bonds publicly offered, bank debentures, and nonresident bonds.

3. Public bonds publicly offered include government securities, municipal bonds, government-guaranteed bonds, and FILP agency bonds.

4. Private bonds publicly offered include straight bonds, asset backed corporate bonds, and corporate bonds with convertible-bond-type subscription rights/warrants.

Source: Japan Securities Dealers Association.

cally due to the deterioration in the fiscal position of local governments, resulting in the introduction of publicly offered municipal bonds targeting local residents in fiscal 2001 and publicly offered joint local government bonds in fiscal 2003.

Among government agency bonds, government-guaranteed bonds amounted to ¥3.1 trillion and FILP agency bonds and others came to ¥4.9 trillion. Following the reform of the fiscal investment and loan program, the Government Housing Loan Corporation issued ¥50 billion worth of the first FILP agency bonds in fiscal 2000. Since then, the combined value of FILP agency bonds issued has grown considerably.

The amount of bank debentures issued stood at ¥1.7 trillion, continuing to decline from the ¥43 trillion recorded in fiscal 1995. These were all interest-bearing bank debentures and the issuance of discount bank debentures has decreased sharply from the ¥30 trillion issued in fiscal 1995. No discount debentures have been issued since fiscal 2013. Behind this drop was the steady decline in operations of long-term credit banks as suppliers of long-term capital to industry. Bank of Tokyo-Mitsubishi (now the Bank of Mitsubishi-Tokyo UFJ) ceased issuing bank debentures in March 2002, followed by similar decisions by Mizuho Corporate Bank in March 2007 and Aozora Bank in September 2011.

The total issue value of corporate straight bonds has followed an upward trend in issuance, reaching ¥10 trillion. The desire of companies to obtain a safe source of funding in the aftermath of the Lehman Shock had prompted an increase in the issuance of straight bonds. Although issuance declined somewhat thereafter, it started to grow in fiscal 2016 and increased to ¥11.4 trillion.

After recovering from the default on Argentine government debt in 2002, the issuance of yen-denominated foreign bonds increased for several years. Issuance of these bonds tends to fluctuate under the influence of such external factors as foreign exchange rates, and the amount issued in fiscal 2016 was ¥1.6 trillion.

3. Methods of Issuing Public Bonds

Government securities are issued in the public market or directly to individual investors or underwritten by the public sector. This section deals with the former two methods of issuance. When issued in the market, JGBs are primarily sold through public auctions based on competitive bidding on price (or on yield), as underwriting by syndicates was discontinued in fiscal 2006. In accordance with the terms of offering set forth by the Ministry of Finance, auction participants submit their bid prices and amounts, and they are then

Table V-2. Categories of Government Securities

Maturity	Short-term government bonds			Medium-term government bonds		Long-term government bonds	
	6-month, 1-year			2-year, 5-year		10-year	
Type of issue	Discount government bonds			Interest-bearing government bonds			
Minimum denomination	¥10,000,000			¥50,000			
Issuance method	Public auction BOJ switch			Public auction OTC sales (based on subscriptions to offering)			
Auction method	Price-competitive bidding Conventional style			Price-competitive bidding Conventional style			
Noncompetitive Bidding, etc.	Non-price Competitive Auctions I			Noncompetitive Bidding Non-price Competitive Auctions I Non-price Competitive Auctions II			
Transfer restriction	Yes (Note 2)			No			
Issuance frequency (FY2014 Plan)	1-year discount bonds: monthly			Monthly			

Maturity	Superlong-term government bonds			Individual investor government bonds	Inflation-indexed government bonds	Floating interest rate government bonds
	20-Year	30-Year	40-Year	3-year, 5-year fixed rate; 10-year floating rate	10-year	15-year (Note 1)
Type of issue	Interest-bearing government bonds					
Minimum denomination	¥50,000			¥10,000	¥100,000	
Issuance method	Public auction			OTC sales (based on subscriptions to offering)	Public auction	—
Auction method	Price-competitive bidding Conventional style		Yield-competitive bidding Dutch auction	—	Price-competitive bidding Dutch auction	—
Noncompetitive Bidding, etc.	Non-price Competitive Auctions I Non-price Competitive Auctions II		Non-price Competitive Auctions II	—	Non-price Competitive Auctions II	—
Transfer restriction	No			Yes (Note 2)	(Note 3)	No
Issuance frequency (FY2014 Plan)	Monthly (Note 4)		Quarterly (Note 4)	Monthly	Quarterly	Not scheduled

Notes: 1. There have been no additional issues of 15-year floating rate JGBs since they were first issued in May 2008.

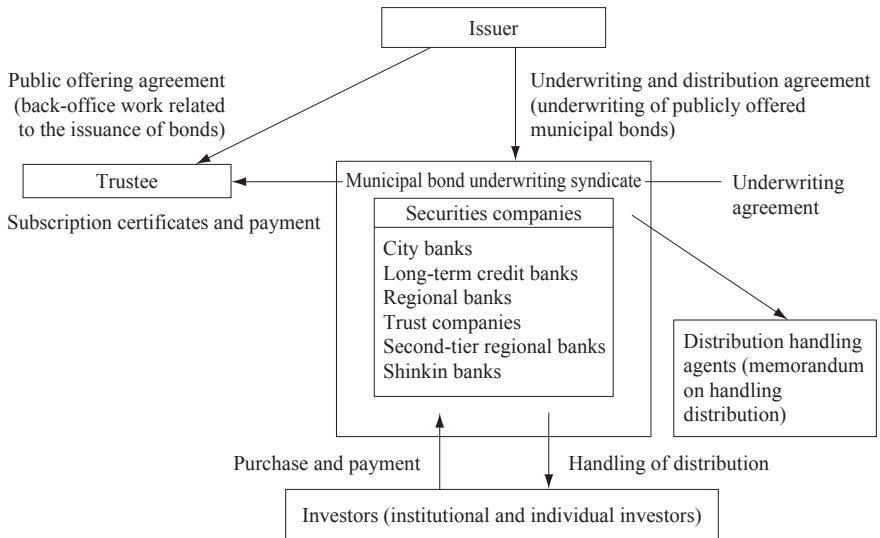
2. Short-term discount bonds are transferable only to corporations (including certain trustees); JGBs for individual investors are transferable only to individuals (including certain trustees).

3. Although inflation-linked bonds are not transferable to individuals, the transfer restriction has been lifted for inflation-linked bonds maturing in January 2016 and thereon effective January 2015, allowing holding of such bonds by individuals. The restriction on transfer to individuals applies to inflation-linked bonds maturing on or before December 31, 2015 even in and after January 2015.

4. The fiscal 2014 issuances of 20-year and 30-year bonds were, in principle, reopenings; bonds issued in March, April, and May were reopenings of the March issuance; those in June, July, and August were reopenings of the June issuance; those in September, October, and November reopenings of the September issuance; and the issuances in January and February 2015 were reopenings of the December 2014 issuance. The March 2015 issuance was partially the same issue as the fiscal 2015 issuance. For 40-year bonds issuance, the May, August, November 2014 and February 2015 issuances were in principal all reopenings of the May 2014 issuance.

Source: Based on the Ministry of Finance, *Debt Management Report* 2016, p. 44.

Chart V-2. Organization of Underwriting Publicly Offered Municipal Bonds at a Glance



Source: Daiwa Securities SMBC, *Saiken-no joshiki* (What Bonds are All About), 2009.

aggregated to determine the issue price and amount. Depending on the type of securities to be auctioned, the issue price is set either in a conventional auction, where bonds are issued to successful bidders at their respective bid prices, or in a Dutch auction, where the issue price (yield) is set at the lowest price (highest yield) among accepted bids. Other than competitive bidding, two-, five-, and ten-year fixed rate JGBs are also offered through a noncompetitive bidding process that facilitates small- and medium-sized bidders and through Non-price Competitive Auctions I and II reserved for special participants (21 companies are designated as of July 15, 2016). Private financial institutions handle subscriptions for individuals in offering JGBs for individuals and in offering two-, five-, and ten-year fixed rate JGBs under the new over-the-counter sales approach.

To issue municipal bonds, a local public body must prepare a budget plan that defines the use of proceeds from the proposed bond issue and obtains the approval of the local assembly. The actual issuance is also subject to consultation with the Minister of Internal Affairs and Communications (MIC) or the governor of the prefecture concerned (local bond consultation system). Even when the issuer is authorized to issue a municipal bond, the proceeds of such bonds can be used only for authorized projects - to finance a publicly run corporation, for equity contributions and loans, and to roll over maturing

debts, etc. As of April 1, 2017, 35 prefectures and 20 cities (“designated cities”) that have been designated by an ordinance of the Ministry of Internal Affairs and Communications have issued municipal bonds through public offerings. In most cases, the issuer negotiates the terms of issue with an underwriting syndicate that handles its public offering, under which the underwriting syndicate buys up whatever bonds remain unsold after the public offering. Municipal bonds publicly offered on the joint primary market (municipal bonds jointly issued by 35 local public bodies) in and after fiscal 2003 are also handled by underwriting syndicates, but the municipal bonds targeted at local residents introduced in March 2002 generally commission local financial institutions to handle the underwriting and subscription administration.

The issuance of government-guaranteed bonds is planned as part of the Fiscal Investment and Loan Program, and annual ceilings on the issue amount must be approved by the Diet. They are issued by way of either an underwriting syndicate or issued by separate and individual bidding by competing underwriters. In the former method, the terms of issue are determined based on the results of recent JGB monthly competitive bidding. In the latter, the terms are bid for competitively along with the lead managing underwriter for the offering. FILP agency bonds are also issued as interest-bearing bonds, and in issuing them, the issuing agency usually selects a lead managing underwriter which, in turn, forms an underwriting syndicate.

4. Methods of Issuing Corporate Bonds

The issuance of straight bonds had in the past been subject to strict regulations, and the corporate bond trustee system was the core of those regulations. Against the backdrop of the main bank system in Japan at the time, the banks had an extremely strong influence on individual corporate straight bond issues under the corporate bond trustee system. Even in the overall corporate bond primary market, banks had a greater voice than securities companies. However, as the role played by the corporate bond trustee system declined in the 1980s, the Commercial Code was amended in 1993 to drastically change the system, and regulations on the issuance of corporate bonds have been substantially eased.

The issuing corporation appoints managing underwriters and other underwriters that together constitute an underwriting syndicate, a bond manager or a fiscal agent, and providers of other relevant services and obtains a preliminary credit rating. When preparations are completed, the underwriting syndicate, under the leadership of managing underwriter, conducts pre-marketing in order to build a book for the bonds. Along with this process, the issue

Table V-3. Corporate Bonds Offering Amounts by Ratings

(millions of yen, %)

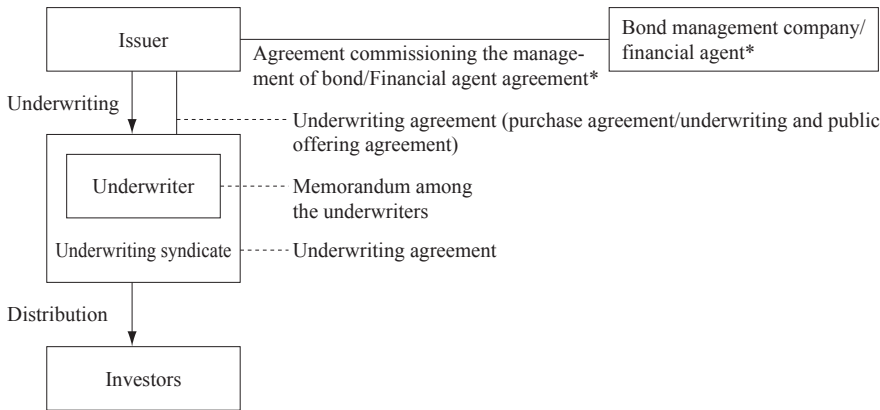
	FY 2011			FY 2012			FY 2013		
	No. of issues	Issue Amount	Proportion of issuance	No. of issues	Issue Amount	Proportion of issuance	No. of issues	Issue Amount	Proportion of issuance
AAA	23	480,000	6.0	2	70,000	0.9	2	60,000	0.8
AA +	24	620,000	7.7	41	965,000	12.0	53	1,170,000	14.8
AA	41	888,000	11.1	76	1,648,000	20.6	60	1,240,000	15.7
AA –	66	2,140,400	26.7	79	2,171,400	27.1	71	1,527,000	19.4
A +	59	1,546,000	19.3	46	896,000	11.2	66	1,089,000	13.8
A	73	1,219,000	15.2	80	1,569,000	19.6	77	1,611,000	20.4
A –	44	665,000	8.3	37	338,000	4.2	54	767,000	9.7
BBB +	28	321,000	4.0	23	278,100	3.5	24	265,000	3.4
BBB	17	147,600	1.8	10	78,400	1.0	13	153,600	1.9
BBB –	0	0	0.0	0	0	0.0	1	1,400	0.0
Total	375	8,027,000	100	394	8,013,900	100.0	421	7,884,000	100.0

	FY 2014			FY2015			FY2016		
	No. of issues	Issue Amount	Proportion of issuance	No. of issues	Issue Amount	Proportion of issuance	No. of issues	Issue Amount	Proportion of issuance
AAA	3	45,000	0.5	18	577,000	8.0	25	850,800	7.5
AA +	34	845,000	9.9	19	326,000	5.0	32	495,000	4.4
AA	50	900,000	10.5	37	870,000	13.0	64	1,168,000	10.3
AA –	69	1,450,000	16.9	46	688,000	10.0	86	1,535,000	13.6
A +	81	1,487,000	17.3	70	1,573,000	23.0	87	2,266,000	20.1
A	67	1,349,600	15.7	58	1,133,000	17.0	82	1,722,000	15.2
A –	63	1,352,000	15.8	52	1,508,000	22.0	85	2,457,000	21.7
BBB +	25	1,071,000	12.5	21	165,000	2.0	27	236,000	2.1
BBB	6	73,000	0.9	2	20,000	0.0	12	571,500	5.1
BBB –	0	0	0.0	0	0	0.0	0	0	0.0
Total	398	8,572,600	100.0	323	6,860,000	100.0	500	11,301,300	100.0

Note: Compiled based on the date of terms of issue. Transportation and broadcast bonds are included.
The highest credit ranking from an agency is used.

Source: I-N INFORMATION SYSTEMS, LTD.

Chart V-3. Mechanism of Underwriting Corporate Bonds



Note: *The issuer signs this agreement with a trustee company in the case of a mortgage bond.

Source: Daiwa Securities SMBC, *Saiken no joshiki* (What Bonds Are All About), 2009.

terms of the bonds are finalized and the offering begins. The book-building method is one under which the lead managing underwriter asks syndicate member companies to survey investors' interest in the bonds and then decides on the issuing terms on the basis of the findings of that survey. Recently, many issuers have employed "spread pricing," a method under which the interest of investors is measured in terms of a spread over the yield of a JGB or an interest rate swap with the same term, to determine the issuing rate.

During recent years, annual corporate straight bond issuance has remained around the ¥8 trillion mark and featured mainly issues with high ratings and a notably small proportion of issues with a low rating. The reason behind this trend is that major institutional investors have limited their investment in corporate bonds to issues with ratings of A or higher. Conversely, most of the issuers of BBB rated bonds are infrastructure-related companies, such as railways and telecommunications, some of which target the retail investor market. Furthermore, in contrast to the United States, there are hardly any BB rated or lower corporate bonds with high yields in the primary market. In 2009, to stimulate the overall corporate bond market, the Japan Securities Dealers Association (JSDA) formed the Study Group to Vitalize the Corporate Bond Market, in which a wide range of measures are being discussed regularly by representatives of securities companies, financial institutions, institutional investors, and related bodies.

Among bank debentures, discount bank debentures used to be issued primarily by Mizuho Bank, Aozora Bank and Shinsei Bank in the past, but issu-

ance has been suspended in recent years. Among other categories, interest-bearing bank debentures are issued in two ways: issuing debentures through a public bond offering on a fixed day and selling them during a certain selling period. In recent years, issuance of these debentures has been on the decline because of the increased diversification of funding sources.

5. Credit-Rating Agencies and Rating of Bonds

Credit rating is a classification of credit risk, indicated by a rating symbol based on measurement of the certainty of payment of the principal of, and interest on, a bond, and it is ordinarily given by an credit-rating agency specializing in rating credit. Originally, the system developed in the bond market of the United States and is believed to have taken root during the Depression of the 1930s. It was introduced to Japan in the 1980s, and today, obtaining a credit rating has become a general practice among issuers of corporate bonds.

In assigning a credit rating to a given bond issue, a credit-rating agency investigates and verifies to see if the issuer has any collateral to back up its obligation and if it has a special financial contract and, if it has preferential or subordinated creditors, analyzes its financial position and business; determines its capacity to pay the principal of, and interest on, the proposed bond; and assigns a symbol on the basis of the findings of such investigations. Normally, any debt security with an AAA rating indicates that its issuer has the highest credit standing and is virtually free from the uncertainties of paying the principal of and interest on the obligation. The creditworthiness of a bond declines as its rating goes down, in order, from AAA to AA, A, and BBB, and a bond with any of these four ratings is called an investment-grade bond. Bonds with a credit rating of BB, B, CCC, CC, or C are called “junk bonds.” As these bonds carry high credit risk, their issuer offers a high yield to attract buyers. Thus, they are called “high-yield bonds,” and their primary market has developed on a relatively large scale in the United States and Europe. This type of junk bond primary market did not exist in Japan because of a policy that excluded bonds that did not meet the eligibility standards from the market. However, today no such regulations restrict the issuance of junk bonds because the eligibility standards were abolished in 1996. Nevertheless, few BBB-rated bonds, let alone junk bonds, have been offered on the market.

Designated credit-rating agencies now include both domestic players, such as the Rating and Investment Information (R&I) and the Japan Credit Rating Agency (JCR), and global agencies, such as Standard & Poor’s and Moody’s and Fitch. In Japan, a new registration system of the credit-rating agencies replaced the conventional system based on the Act for Partial Amendment of the Financial Instruments and Exchange Act enforced in April 2010. Further,

Table V-4. Definitions of Credit-Rating Symbols

Rating and Investment Information, Inc. (R&I)	
Credit Rating	Definition
AAA	Highest creditworthiness supported by many excellent factors.
AA	Very high creditworthiness supported by some excellent factors.
A	High creditworthiness supported by a few excellent factors.
BBB	Creditworthiness is sufficient, though some factors require attention in times of major environmental changes.
BB	Creditworthiness is sufficient for the time being, though some factors require due attention in times of environmental changes.
B	Creditworthiness is questionable and some factors require constant attention.
CCC	Creditworthiness is highly questionable and a financial obligation of an issuer is likely to default.
CC	All of the financial obligations of an issuer are likely to default.
C	R&I believes that all of the financial obligations of an issuer are in default.

Japan Credit Rating Agency, Ltd. (JCR)	
Credit Rating	Definition
AAA	The highest capacity of the obligor to honor its obligation to its financial commitment.
AA	A very high capacity to honor its obligation to its financial commitment.
A	A high capacity to honor its obligation to its financial commitment.
BBB	An adequate capacity to honor its obligation to its financial commitment. However, this capacity is more likely to diminish in the future than in the cases of the higher rating categories.
BB	Although the capacity to honor the financial commitment on the obligation is not considered problematic at present, this capacity may not persist in the future.
B	A low capacity to honor its obligation to its financial commitment, giving cause for concern.
CCC	There are factors of uncertainty that the obligation to financial commitment will be honored, and a possibility of default.
CC	A high default risk.
C	A very high default risk.
D	In default.

Moody's Investor Service	
Credit Rating	Definition
Aaa	Obligations rated "Aaa" are judged to be of the highest quality, subject to the lowest level of credit risk.
Aa	Obligations rated "Aa" are judged to be of high quality and are subject to very low credit risk.
A	Obligations rated "A" are considered upper-medium grade and are subject to low credit risk.
Baa	Obligations rated "Baa" are subject to moderate credit risk. They are considered medium grade and as such may possess certain speculative characteristics.
Ba	Obligations rated "Ba" are judged to be speculative elements and are subject to substantial credit risk.
B	Obligations rated "B" are considered speculative and are subject to high credit risk.
Caa	Obligations rated "Caa" are judged to be speculative of poor standing and are subject to very high credit risk.
Ca	Obligations rated "Ca" are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.
C	Obligations rated "C" are the lowest rated class and are typically in default, with little prospect for recovery of principal or interest.

Standard & Poor's	
Credit Rating	Definition
AAA	An obligation rated "AAA" has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its obligation to its financial commitment is extremely strong.
AA	An obligation rated "AA" differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its obligation to its financial commitment is very strong.
A	An obligation rated "A" is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its obligation to its financial commitment is still strong.
BBB	An obligation rated "BBB" exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its obligation to its financial commitment.
BB	An obligation rated "BB" is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its obligation to its financial commitment.
B	An obligation rated "B" is more vulnerable to nonpayment than obligations rated "BB," but the obligor currently has the capacity to meet its obligation to its financial commitment. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its obligation to its financial commitment.
CCC	An obligation rated "CCC" is currently vulnerable to nonpayment and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its obligation to its financial commitment. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its obligation to its financial commitment.
CC	An obligation rated "CC" is currently highly vulnerable to nonpayment. The "CC" rating is used when a default has not yet occurred, but Standard & Poor's expects default to be a virtual certainty, regardless of the anticipated time to default.
C	An obligation rated "C" is currently highly vulnerable to nonpayment, and the obligation is expected to have lower relative seniority or lower ultimate recovery compared to obligations that are rated higher.
D	An obligation rated "D" is in default or in breach of an imputed promise. For non-hybrid capital instruments, the "D" rating category is used when payments on an obligation are not made on the date due, unless Standard & Poor's believes that such payments will be made within five business days in the absence of a stated grace period or within the earlier of the state period or 30 calendar days. The "D" rating also will be used upon the filing of a bankruptcy petition or the taking of similar action and where default on an obligation is a virtual certainty, for example due to automatic stay provisions. An obligation's rating is lowered to "D" if it is subject to distressed exchange offer.
NR	This indicates that no rating has been requested, or that there is insufficient information on which to base a rating, or the Standard & Poor's does not rate a particular obligation as a matter of policy.

in recent years, municipal bonds and FILP agency bonds have also come to be rated.

The outbreak of the U.S. subprime loan problem raised strong doubts over the way ratings were given. To begin with, there were criticisms pointing out that credit-rating agencies tended to give generous ratings because their source of income was rating fees collected from issuers. Meanwhile, from a different perspective, ratings were acknowledged as nothing more than reference. Currently, however, ratings are used in various financial regulations and policies. Credit-rating agencies today operate under a registration system also on a global basis and are placed under administrative supervision.

6. Corporate Bond Management

A drastic reform of the conventional corporate bond trustee system was carried out by amending the Commercial Code in June 1993. Under this amendment, the conventional name “bond trustee company” was changed to “bond management company,” and its function was clarified. More specifically, (1) the establishment of a bond management company was made mandatory, in principle, and the eligibility for becoming one is restricted to banks, trust companies, and companies that have received a license under the Mortgage Bond Trust Law; (2) services to be provided by a bond management company are restricted to the management of bonds that have been issued and are outstanding; and (3) the power, duty, and liability of the bond management company has been clarified. Put another way, the back-office services provided by the trust company at the time a bond is offered will not become the core services of the bond management company, and the services to be provided by the bond management company after a bond is issued are restricted to bond management.

As a result of the amendment, the possibility of a bond trustee company being involved in the issuance of corporate bonds of individual issuers has been legally removed, and the power of the conventional bond trustee system regulating individual issuers has thus come to an end. The amendment has resulted in the following changes: (1) The fee the trustee bank had been collecting was renamed “bond management fee,” and it was sharply lowered; (2) by instituting exceptional provisions with respect to the mandatory establishment of a bond management company (this applies when the face value of a bond certificate is in excess of ¥100 million), issuers can appoint a fiscal agent in lieu of a bond management company, and instances of making do with a fiscal agent have since increased; and (3) as the services to be provided by the bond management company have been clarified, the lump purchases of defaulted bonds that trustee banks had been making were discontinued,

Table V-5. Appointment, Power, and Liability of the Bond Manager under the Companies Act

Item	Contents	Article
Appointment and Power		
When a bond manager has to be appointed	A corporation issuing a corporate bond must appoint a bond manager. However, when the face value of a bond certificate is in excess of ¥100 million, and in such other cases as may be prescribed by an ordinance of the Ministry of Justice as one which poses no threat to the protection of bondholders, the issuer need not appoint a bond manager.	Article 702 of the New Companies Act
Qualifications for becoming a bond manager	Banks, trust companies, and equivalent financial institutions	Article 703
Matters entrusted	The bond manager will be entrusted to receive payments, to preserve rights of claim, and to take other steps necessary for the management of bonds on behalf of bondholders.	Article 702 of the New Companies Act
Duty of the bond manager	The bond manager must perform the administration of bonds in a fair and sincere manner on behalf of the bondholders ("duty of fairness"). The bond manager must manage the bonds with due care of a prudent manager to the bondholders ("duty of due care of a prudent manager"). The exercise of contracted power (bond manager's power of representation) based on an agreement entrusting the management of the bond is included in the management of the bond.	Article 704
Power of the bond manager	The bond manager has the authority do all judicial and non-judicial acts on behalf of bondholders that are necessary to receive payments relating to the bonds or to preserve the realization of claims relating to the bonds. When the bond manager deems it necessary to take such steps, the bond manager may, with the permission of the court, investigate the status of the business and assets of the bond-issuing company.	Paragraphs 1 and 4 of Article 705
Special regulation on the power of the bond manager	When the bond manager plans to take the steps described below, it must obtain a resolution of a bondholders' meeting.	Paragraphs 1 and 2 of Article 706
	(1) With respect to all of the bonds, granting extension for the payment of those bonds, or releasing, or settling liability arising from the failure to perform the obligations of those bonds (2) With respect to all of the bonds, prosecuting lawsuits, or proceeding with bankruptcy procedures, rehabilitation procedures, reorganization procedures or procedures regarding special liquidation ("lawsuit" includes court-mediated settlement) Under the Act, the bond manager has the power to take these actions without a resolution of a bondholders' meeting if the bond management agreement so prescribes.	Item (viii), Article 676
Power of the bond manager in taking steps for the protection of creditors	When a bondholder wants to object to any action taken by the issuer, he/she must obtain a resolution of a bondholders' meeting, in principle, but the bond manager can express its objection on behalf of bondholders. This, however, shall not apply in cases where there is a provision to the contrary in the contract entrusting bond management.	Paragraphs 1 and 2, Article 740
Liability		
Liability (damages)	When the bond manager takes an action in violation of the Companies Act or any resolution of the bondholders' meeting, it is jointly and severally liable for damages incurred by bondholders.	Paragraph 1 of Article 710
Statutory special liability (damages)	(1) When the bond manager has received from the issuer of a bond collateral for the obligation represented by such a bond or when the issuer has taken an action extinguishing such obligation within three months prior to a default on the redemption of, or on the payment of interest on, the bond, or the suspension of payment by its issuer (2) When the bond manager has received from the issuer collateral for the obligation or repayment with respect to the credit of the bond manager (3) When the bond manager transfers its credit to a company controlling, or controlled by, such bond manager, or to another company that has a special relationship with the bond manager (4) When a bond manager who has a credit to the issuer of the bond concludes an agreement with the issuer authorizing it to dispose of the property of the issuer for the purpose of offsetting such credit, or when the bond manager concludes an agreement to take over any obligations of any company that owes a debt to the issuer. (5) When a bond manager that owes a debt to the issuer offsets such debt by taking over a credit to the issuer.	Paragraph 2 of Article 710
Exemption of debt	The bond manager is exempt from debt when it has not been derelict in its management of the bond, or when it is established that any loss caused to the bondholders is not blamable to an action taken by the bond manager.	Proviso to Paragraph 2 of Article 710
Resignation of the bond manager and its liability	(1) The bond manager may resign with the consent of the bond issuer and the bondholders' meeting. (However, the bond manager must appoint in advance a successor who will take over the administration of the bonds.) (2) In case the bond manager has an unavoidable reason to resign, it may resign with permission of the competent court. (3) The bond manager may resign based of the causes prescribed in the agreement entrusting the management of the bonds. (However, such agreement must have a provision designating a succeeding bond manager that will take over the job.) (*) A bond manager that resigns after the issuer has defaulted on the redemption of the bond or on the payment of interest on such bond, or that has resigned for reasons prescribed in the agreement commissioning the management of the bond within three months prior thereto, is not exempted from liability to pay damages under Paragraph 2 of Article 710.	Article 711
		Article 712

Source: Compiled from the data drawn from Akihiro Sato, *Shinkaishaho de kawatta kaisha no shikumi* (The Changed Company System under the New Companies Act), Nihon Horei, 2005, pp. 179 and 181.

and this practice has since become established.

Under the New Companies Act adopted in June 2005 (enforced in May 2006), a bond management company is now known as a “bond manager,” and its liability and power have been expanded. More specifically, (1) under the former Commercial Code, the term “management of corporate bond” referred only to the exercise of power legally granted to the bond management company and did not include the exercise of power based on an agreement, etc., entrusting the management of bonds (contractual power); under the new Companies Act, however, the exercise of the contractual power is included in “the management of bonds” and the bond manager owes the duty of fairness and the duty of due care of a prudent manager; (2) when the agreement entrusting the management of bonds contains a provision to that effect, the bond manager may act in relation to filing a lawsuit and taking bankruptcy or rehabilitation proceedings for all of the bonds without obtaining a resolution of the bondholders’ meeting; and (3) in taking steps to protect the creditors in the case of a capital reduction or a merger, the bond manager may, in principle, object to such capital reduction or merger without obtaining a resolution of the bondholders meeting.

The Study Group to Vitalize the Corporate Bond Market previously described takes into consideration the current situation in which a bond manager is not assigned and discusses in its report a wide of range of roles that a bond manager may possibly undertake.

7. Corporate Bonds with Subscription Rights/Warrants and Structured Bonds

Subscription rights/warrants give their issuer an obligation to either issue new shares or transfer shares in its treasury at a predetermined price to the rights/warrants holder upon the exercise of their rights/warrants within a prescribed period.

Corporate bonds with subscription rights/warrants are divided into those that in effect correspond to convertible bonds and those with undetachable warrants. Corporate bonds with subscription rights/warrants correspond to the former and refer to bonds (1) from which the rights cannot be detached or separately transferred, (2) whose issue value is equal to the amount of money payable upon the exercise of the rights, and (3) for which the exercise of the subscription rights/warrants is always based on the contribution in kind of the corporate bonds (debt equity swap). Except in the case of a stock split, the conversion price is fixed at the time of its issue. In certain cases, however, the conversion price of rights may be revised downward when the price of its underlying stock falls. Among these cases, bond issued under the condi-

Table V-6. Kinds of Structured Bonds

<p>[Variable Cash Flow Bonds]</p> <p>Step-up Bond: A bond issued initially with a coupon rate that is lower than the going rate then prevailing and that rises after the lapse of a certain period. By its very nature, the issuer often issues such a bond with a call option.</p> <p>Step-down Bond: A bond issued initially with a coupon rate that is higher than the going rate then prevailing and that declines after the lapse of a certain period.</p> <p>Deep-Discount Bond: This bond carries an interest rate lower than the going rate throughout its life, but it is issued at an under-par price to help its holders make up for the lower coupon by a redemption gain.</p> <p>Reverse Floater Bond: The coupon rate of this bond falls when the interest rate rises, and the coupon rate rises when the interest rate declines. This is a kind of derivative bond using interest rate swap.</p> <p>[Index Bonds]</p> <p>Stock, interest rate, or bond-index-linked bond: These are bonds whose redemption principal is linked to the Nikkei average, whose coupon rate is linked to the Nikkei average, whose coupon rate is linked to the interest swap rate, or whose redemption principal is linked to the Japanese government bond futures price.</p> <p>Exchange Rate Index Bond: Most of these dual-currency bonds are divided into those with a principal and coupon in yen that are redeemable in a foreign currency and into reverse dual-currency bonds with a principal and coupon redeemable in yen that carry a coupon in a foreign currency. As the amount of principal is normally larger than the coupon, dual-currency bonds carry a larger risk of exchange rate fluctuation.</p> <p>[Bonds with Options]</p> <p>Exchangeable Bonds (EB): Issuers of this bond may at their discretion pay redemptions with a pre-fixed number of shares of another company. For the purchaser, this means the sale of a put option, and under this arrangement, the coupon increases by as much as the option premium.</p> <p>Other Bonds with Options: Included in this kind are callable bonds (the issuer can call the bond in advance of its maturity at the discretion of the issuer); puttable bonds (its holder can demand redemption in advance of its maturity); and knock-in, dual-currency bonds (a dual-currency bond with an exchange-rate option).</p>

Source: Compiled on the basis of the data drawn from the website of Hephaistos Investment Research (http://hephaistos.fc2web.com/bond_guide/shikumi_sai.html) (Japanese) and the website of The Central Council for Financial Services Information

tion that the conversion price can be adjusted downward with a frequency of one or more times every six months are called “corporate bonds with subscription rights/warrants with adjustable conversion price (MSCBs: moving strike convertible bonds).” Because of market concerns about this type of “death spiral” financing, however, few of these types of bonds have been issued recently. On the other hand, as corporate bonds issued with detachable warrants are deemed a concurrent offering of corporate bonds and equity warrants, only those with undetachable warrants are included in the definition of “corporate bonds with subscription rights/warrants.” In such case, the money to be paid upon the exercise of subscription rights/warrants should be paid additionally, and the bond remains outstanding.

“Structured bond” is the name popularly given to a bond structured with derivatives. In recent years, various types of structured bonds have been issued. A bond linked to the Nikkei average is a structured bond that incorporates Nikkei average options trading. In general, when the Nikkei average rises, the deal generates a higher return, but when it falls, the option is exercised, causing a loss, and the bond price falls below its par value. A corporate bond with a clause to convert it into shares of another company (“exchangeable bond” or EB) is a bond that incorporates a stock option of the target company. In general, when the stock price of such corporation rises, the deal generates a higher return because the holder can acquire the option fee, but when the price of its stock falls, the option is exercised, and the holder has to accept the share at a lower price and suffers a loss. However, unlike in the case of a bond linked to the Nikkei average, the holder can hold the share until its price recovers. Recently there have been fewer issuances of structured bonds because of repeated cases of these bonds being sold to investors who did not adequately understand the risks involved, resulting in occasional court cases contesting whether securities companies had violated their obligation to properly explain these products before selling them.

CHAPTER VI

The Secondary Markets for Bonds

1. Trading of Bonds

Bonds are circulated by two different methods: (1) trading on a market operated by a financial instruments exchange, and (2) negotiated transaction between an investor and a securities company or other market intermediary. The former is referred to as an exchange transaction and the latter as an over-the-counter (OTC) transaction. OTC transactions account for the majority of transactions on the bond secondary market.

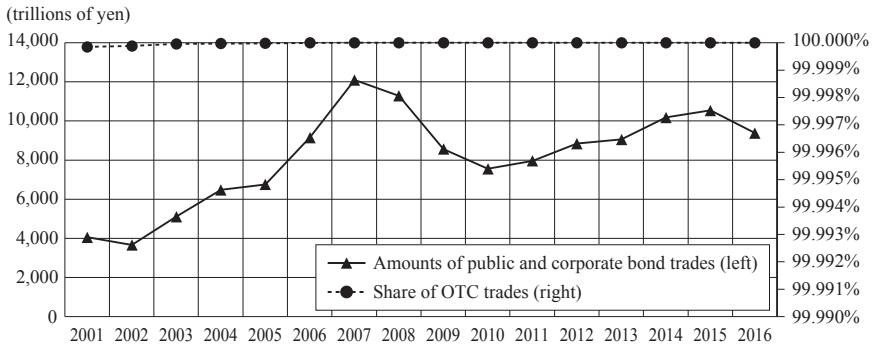
Conventionally, the trading volume on the secondary market for bonds was limited and amounted to only ¥58 trillion in fiscal 1975, but subsequently continued to increase and topped the quadrillion level in 2007. Although the trading volume declined thereafter to levels of around ¥7,500 trillion, it has turned upward in recent years and reached a near-quadrillion level in 2016.

Looking at the bond trading volume by bond type, trading of JGBs account for over 90% of all trading. The government has continuously been issuing massive amounts of JGBs, resulting in a large increase in those outstanding in the market and driving the expansion of the bond secondary market.

This trend has remained constant in recent years. Comparing the change from 2010 to 2016, while the trading volume of JGBs on the OTC market increased ¥1,838 trillion, the overall increase was ¥1,820 trillion. As such, government securities outweigh by far other categories of bonds in overall fixed income trading volume. The dominance of government debts stems mostly likely from the difference in liquidity, which in turn is mainly because government debts are considered risk free in Japan and attract funds for various investment needs.

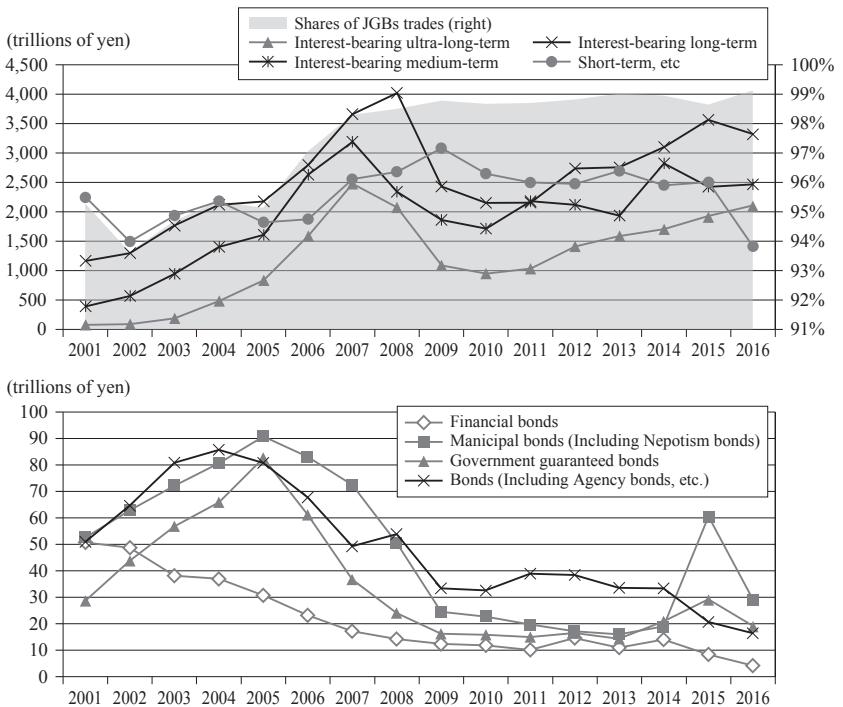
For the sake of development of secondary markets for bonds in Japan going forward, it is important that bonds other than JGBs are traded actively. Recognizing the need to vitalize the corporate bond market, which plays an important role in corporate finance, the Japan Securities Dealers Association (JSDA) issued, in 2009, a report titled, “Toward Vitalization of the Corporate Bond Market” that organized the issues faced by the country’s corporate bond market and also proposed specific measures to create a more efficient

Chart VI-1. Annual Amount of Purchasing and Selling of Bonds (Face Value Basis) and Share of OTC Trades



Note: Figures include *gensaki* trades and exclude corporate bonds with equity warrants.
Source: Japan Securities Dealers Association, Japan Exchange Group.

Chart VI-2. Bond Trading volume by Bond Type



Note: Including the repurchase trading volume, excluding the bonds with stock acquisition rights.
Source: Japan Securities Dealers Association.

corporate bond market with higher transparency and liquidity. The report went on to state that vitalization of the Japanese corporate bond market would be an important factor in Japan's new economic growth strategy and that the public and private sectors should actively cooperate in advancing the measures.

Some of the specific initiatives taken by the JSDA are described later in this Chapter.

2. Participants in the Secondary Bond Market

Looking at the OTC bond market by type of investor or transaction party, trading is dominated by bond dealers, such as securities companies. In trading bonds, it is important that the transaction needs of market participants be met as quickly as reasonably possible. That said, due to the large number of issues and wide variety of transaction forms, it is not easy to rapidly locate a matching counterparty for a particular transaction. Therefore, in most bond transactions, securities companies or dealer banks act as the counterparty, buying or selling as principal to facilitate client trading. Furthermore, securities companies, etc. trade bonds based on their own market view, which adds to their overall trading volume. Following bond dealers, entities grouped as "others" account for the next largest share of the total volume. This group includes the Bank of Japan, which functions as the underwriting agent for JGBs and also buys and sells a range of debt securities as part of its open market operations. Nonresident investors also are playing an increasingly large role in the Japanese bond market as a means of investing in yen. They are active players in the short-term JGB market, trading T-bills, and others. Among other categories, city banks (large commercial banks) and trust banks trade large volumes of bonds. In response to the recent difficult investment environment, city banks vigorously engage in bond trading in pursuit of trading profits as well as resell municipal and other bonds underwritten by them based on their own market view. It should also be noted that trust banks have traditionally allocated large shares of assets under management or administration, including pension assets, to bonds.

When measured in terms of difference between selling and buying transactions, almost all business categories have been net buyers of bonds in recent years. The backdrop to this trend has been the ongoing low-interest-rate climate caused by recent economic conditions, financial crises, and other issues. The continued trend among many business categories to be net buyers of bonds can be attributed to financial institutions' reduced risk tolerance in their loan portfolios. Another contributing factor to the net buyer trend has been the flight of risk money into the low-risk, high-liquidity JGB market in

Table VI-1. Trends in Bond Transactions by Investor Type

(Figure on the top line is the total of buy and sell; figure on the lower line is the net of buy and sell and negative figure denotes selling on balance)

(¥10 billion)

	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
City (commercial) banks	25,102 (990)	28,411 (2,553)	29,087 (3,706)	29,105 (-193)	46,511 (-1,997)	40,150 (-2,861)	18,599 (-2,837)	25,407 (-2,630)	12,709 (-973)	6,085 (1,064)
Regional banks	3,624 (604)	3,733 (1,002)	4,479 (1,172)	4,857 (1,130)	5,891 (1,020)	5,765 (644)	4,140 (482)	4,550 (303)	3,480 (51)	2,525 (-80)
Trust banks	24,190 (4,086)	20,089 (3,976)	24,174 (7,599)	24,928 (6,409)	24,789 (8,252)	22,294 (8,109)	16,800 (5,478)	14,175 (1,298)	10,861 (561)	10,000 (299)
Agriculture-related banking institutions	1,814 (32)	2,665 (1,336)	4,430 (2,999)	4,993 (4,002)	3,356 (2,221)	3,099 (2,126)	1,764 (779)	1,307 (486)	1,000 (232)	975 (240)
Other banking institutions	8,917 (3,649)	7,708 (3,258)	5,795 (3,277)	5,607 (3,278)	5,448 (2,346)	4,266 (2,602)	3,475 (2,016)	2,636 (790)	2,128 (806)	1,631 (578)
Life and property casualty insurance companies	3,756 (941)	4,594 (1,234)	3,653 (1,743)	4,186 (1,457)	4,583 (1,896)	4,826 (1,631)	4,256 (1,387)	2,704 (908)	1,956 (507)	1,555 (404)
Investment Trusts	3,220 (1,978)	2,920 (1,498)	2,856 (1,890)	2,886 (1,963)	2,885 (2,100)	3,108 (2,309)	4,318 (3,165)	4,372 (3,045)	3,961 (2,284)	2,139 (416)
Public employees mutual aid associations	786 (611)	635 (459)	368 (245)	311 (208)	277 (166)	299 (213)	210 (151)	114 (54)	115 (15)	84 (5)
Corporations	1,130 (960)	1,113 (886)	1,302 (1,250)	1,435 (1,336)	1,003 (922)	1,203 (1,093)	1,281 (1,104)	696 (630)	320 (256)	81 (40)
Entities not domiciled in Japan	30,233 (5,808)	28,834 (8,184)	26,835 (8,474)	31,074 (11,213)	36,902 (14,891)	34,131 (15,997)	34,799 (16,300)	35,730 (20,103)	37,609 (21,575)	36,466 (21,814)
Others	44,845 (-22,043)	45,857 (-25,860)	53,324 (-34,216)	50,173 (-30,605)	52,719 (-31,408)	58,930 (-30,369)	62,355 (-26,367)	60,975 (-23,756)	61,742 (-24,673)	56,869 (-22,866)
Bond dealers	195,292 (-450)	173,877 (182)	168,735 (248)	181,423 (-315)	179,035 (-570)	164,805 (-1,172)	162,073 (-661)	187,339 (-223)	142,679 (-446)	116,243 (-465)
Total (including other investors)	347,880 (-36)	326,112 (1,552)	331,212 (1,319)	347,491 (1,843)	369,000 (1,253)	348,505 (1,432)	318,446 (2,222)	344,034 (1,984)	281,281 (557)	236,550 (1,490)

Note: These figures exclude the purchasing and selling value of repurchase agreements.

Source: Japan Securities Dealers Association.

reaction to the depressed stock market and the turmoil in the securitized product and commodity markets. Interestingly, amid this net buyer trend, city banks were net sellers from fiscal 2010 to fiscal 2015. This reversal likely reflects the commercial banks' desire to capture some profit given recent stable bond prices. On the other hand, the "others" category has become a consistent and substantial net seller of bonds because primary JGBs issued by auction are settled via the BOJ and reported as sales by the central bank.

3. Over-the-counter Bond Transactions

Depending on where transactions take place, the circulation of bonds may be divided into exchange transactions and over-the-counter (OTC) transactions.

An overwhelming majority of bond transactions takes place over the counter rather than on exchanges. This is due to the following reasons: (1) there are so many issues of bonds that it is practically impossible to list all of them on exchanges; (2) due to the wide variety of bond transaction forms and other specifications that different buyers and sellers require, it is difficult to instantly locate a matching counterparty for a particular transaction; (3) corporate investors, who account for the bulk of the bond trading volume, tend to trade in large lots and often carry out complex transactions involving more than one issue; and (4) tax on bond interest varies according to the tax profiles of bondholders. Due to these reasons, bond transactions, in general, do not lend themselves to trading on exchanges, where the terms of transactions need to be standardized. Bonds are more efficiently traded over the counter, where trades are executed based on the terms individually negotiated between buyers and sellers.

Unlike exchange markets, where all orders for a particular security are concentrated in a single marketplace, OTC trading, in essence, is a decentralized transaction process based on one-to-one negotiation that is conducted over the counter at individual securities companies, etc. In that sense, it may be said that the counter of each securities company is a market in itself and that there are as many OTC markets as there are securities companies. A wide variety of transactions may be executed over the counter once an investor and a securities company agree on their terms. Private placement bonds as well as publicly offered bonds may be traded, and the delivery and settlement procedures are to be agreed upon between the buyer and the seller. The transaction price can also be decided between the two parties, often in reference to the prices of other relevant financial instruments.

In OTC trading, a securities company, etc. first buys bonds that a client offers to sell and then resells them to another client afterward. When a client wants to buy bonds, it sells them out of its inventory or sells short. These types of transactions are generally referred to as “principal transactions.”

4. Reference Statistical Prices (Yields) for OTC Bond Transactions (1)

As OTC bond trading is a negotiated process between a securities company, etc. and a client, it is difficult for a third party to discover the price at which a transaction is consummated. Publication of prices and other information con-

Table VI-2. Bond Trading by Market

(¥10 billion)

		Government securities	Corporate bonds with subscription rights/warrants	Others
FY2007	Stock Exchanges	0	48	0
	Over the counter	1,232,317	62	21,059
FY2008	Stock Exchanges	0	66	0
	Over the counter	1,036,073	72	15,042
FY2009	Stock Exchanges	0	112	0
	Over the counter	781,286	52	9,175
FY2010	Stock Exchanges	0	56	0
	Over the counter	761,950	70	10,175
FY2011	Stock Exchanges	0	40	0
	Over the counter	829,983	46	10,773
FY2012	Stock Exchanges	0	30	0
	Over the counter	842,314	45	9,760
FY2013	Stock Exchanges	0	27	0
	Over the counter	936,753	24	9,230
FY2014	Stock Exchanges	0	8	0
	Over the counter	1,039,157	11	11,273
FY2015	Stock Exchanges	0	30	0
	Over the counter	1,025,087	20	14,432
FY2016	Stock Exchanges	0	18	0
	Over the counter	921,027	31	7,335

Note: The figures for exchange trading volume are double those actually reported by exchanges to account for both buy and sell sides of transactions.

Source: Japan Securities Dealers Association and stock exchanges.

cerning OTC bond transactions not only helps efficient and orderly trading of bonds but is also of critical importance from the standpoint of investor protection by promoting the formation of fair prices and facilitating investors' access to trading at the best possible price. Publication of bond prices is thus indispensable for the development of bond markets.

With a view to providing investors, securities companies, and others with reference information, the JSDA instituted the System for Dissemination of Reference Statistical Prices (Yields) for OTC Bond Transactions, which publishes (midpoint between buy and sell quotes) quotes for publicly offered

Table VI-3. Breakdown of Major Bond Categories, by Outstanding Balance and Number of Issues

(¥10 billion, No. of issues)

		Government securities	Municipal bonds (public offering)	Government-guaranteed bonds; FILP agency bonds	Straight bonds; asset backed corporate bonds	Corporate bonds with subscription rights/warrants	Bank debentures (interest bearing and discount)
FY2007	No. of Issues	372	1,836	1,108	2,560	84	1,978
	Outstanding balance	681	38	57	55	1	22
FY2008	No. of Issues	395	2,010	1,200	2,486	55	1,838
	Outstanding balance	677	41	58	57	1	21
FY2009	No. of Issues	410	2,208	1,350	2,513	41	1,664
	Outstanding balance	716	45	61	60	1	19
FY2010	No. of Issues	423	2,376	1,474	2,614	32	1,514
	Outstanding balance	755	48	63	63	1	17
FY2011	No. of Issues	449	2,525	1,634	2,684	21	1,272
	Outstanding balance	781	52	64	63	1	15
FY2012	No. of Issues	470	2,655	1,772	2,733	17	1,163
	Outstanding balance	814	55	66	61	1	14
FY2013	No. of Issues	476	2,805	1,916	2,844	18	900
	Outstanding balance	848	57	69	61	0	12
FY2014	No. of Issues	493	2,917	2,021	2,883	22	789
	Outstanding balance	873	58	69	60	0	12
FY2015	No. of Issues	497	3,008	2,151	2,847	24	526
	Outstanding balance	901	59	69	58	0	11
FY2016	No. of Issues	506	3,059	2,244	2,977	26	428
	Outstanding balance	927	60	68	60	0	10

Note: Outstanding balance figures are in trillions of yen.

Source: The Japan Securities Dealers Association.

bonds that meet certain criteria. The system was originally instituted in August 1965 by the Bond Underwriters Association of Japan for publishing OTC Quotes for Industrial Debentures and was succeeded by the Tokyo Securities Dealers Association, the predecessor of the JSDA, which began the system for dissemination of OTC quotations of bonds in March 1966. The initiatives were implemented with a backdrop of social necessity to promote the formation of fair prices and efficient and orderly trading for JGBs, issu-

Table VI-4. The System for Dissemination of Reference Statistical Prices (Yields) for OTC Bond Transactions

<p>1. Outline</p> <p>(1) Purpose</p> <p>To publish quotations reported by member companies appointed by the Japan Securities Dealers Association to be used as reference by member companies of the association and their clients in trading bonds over the counter between them.</p> <p><i>Note:</i> In August 1965, the Bond Underwriters Association started publishing quotations on OTC industrial bonds. Subsequently, the Tokyo Securities Dealers Association started publishing OTC bond quotations in March 1966, and improvements have been made on several occasions thereafter.</p> <p>(2) Calculation of Reference Statistical Prices (Yields) for OTC Bond Transactions</p> <p>The JSDA receives reports from its member companies affiliated with the system (14 securities companies as of February 28, 2018) on quotations of trades with a face value of approximately ¥500 million as of 3:00 p.m. each trading day. The JSDA computes the reference prices (yields) of a given issue on the basis of an arithmetic average of quotations on issues with respect to which it has received reports from five or more member companies.</p>

ance of which had been resumed after the war with a view to contributing to public interest and investor protection. The system has since undergone many changes and improvements in response to the changing environment surrounding the bond market. During that period, the number of published issues has ballooned from about 300 when the system was introduced to approximately 9,300. In August 2002, the JSDA changed the name of the data to Reference Statistical Prices (Yields) for OTC Bond Transactions with the intention of clearly indicating that it is for reference purposes. At the same time, the system was enhanced by publishing high, low, and median values of surveyed quotes in addition to their averages, which was the only data previously published.

Since the system started publishing bond quotes 50 years ago, its use has evolved from the original purpose of providing price references for OTC bond trading in Japan. In addition to that role, it has become widely used for mark to market valuation for financial reporting and tax accounting purposes and the valuation of collateral for different types of transactions. This expanded function demands an even greater degree of confidence in the system. As a result, in 2013 a review was made of the quotation system primarily with regard to publishing reference statistical prices (yields) for corporate straight bonds. The new system arising from that review began operation in November 2015.

Table VI-5. History of System for Dissemination of Reference Statistical Prices (Yields) for OTC Bond Transactions

	Kinds of selectable issues	No. of selected issues
March 1966 Over-the-counter quotes announced · Date of announcement (Thursday of each week)	Government securities, municipal bonds, government-guaranteed bonds, coupon bank debentures, corporate bonds, telegraph and telephone (TT) coupon bonds subscribed to by subscribers, discount TT bonds, and such other bonds as may be recognized by the Japan Securities Dealers Association (JSDA)	No. of issues announced: 280 (as of May 12, 1966)
January 1977 · Announcement of bench-mark and standard quotes (Benchmark quotes are announced every day except Saturday. Standard quotes are announced once a week on Thursday.)	(1) Benchmark quotes (for institutional investors) are selected from such bonds whose volume of trading correctly reflects the movement of the market. (2) Standard quotes (for small-lot investors) are selected from one of government securities, municipal bonds, special debts, bank debentures, corporate bonds, and yen-denominated foreign bonds, other than those listed in (1) above in terms of maturities and interest rates.	(1) Benchmark quotes: Issues announced: 14 (as of January 31, 1977) (2) Standard quotes: Issues announced: 77 (as of January 27, 1977)
August 1978 · Announcement of bench-mark and standard quotes (bid and ask quotations are announced). (Benchmark quotes are announced every day except Saturday. Standard quotes are announced once a week on Thursday.)	The same as above.	(1) Benchmark quotes: Issues announced: 19 (as of August 31, 1978) (2) Standard quotes: Issues announced: 137 (as of August 31, 1978)
January 1992 · Standard quotes on OTC bonds are announced daily.	One of the government securities, municipal bonds, government-guaranteed bonds, bank debentures, corporate bonds, and yen-denominated foreign bonds that are not listed is selected in terms of kinds, maturities, and interest rates.	Issues announced: 298 (as of January 31, 1992)
April 1997 · No. of selectable issues was sharply increased (the new system started operating.)	Publicly offered but unlisted bonds (with a remaining life of one year or longer) that maintain a fixed interest rate throughout their life and redeem their principal in a lump sum were selected.	Issues announced: 1,746 (as of May 1, 1997)
December 1998 · The duty to concentrate its trading on the exchange market was abolished.	Publicly offered bonds (with paid-in principal, interest, and redemption money all paid in yen) are selected.	Issues announced: 2,867 (as of December 1, 1998)
August 2002 · Name of system changed to "Reference Statistical Prices (Yields) for OTC Bond Transactions." In addition to average values, highs, lows and medians are announced.	The same as above.	Issued announced: 4,198 (as of August 1, 2002)
December 2013 · Decision made to revise the calculation method for corporate and other bonds and announce quotes earlier.	The same as above.	Issued announced: 7,931 (as of December 2, 2013)
November 2015 · Start of operation of revised system	The same as above.	Issued announced: 8,257 (as of November 2, 2015)

Note: Selected issues reported on and after August 5, 2002, were transferred to the System for Dissemination of Reference Statistical Prices (Yields) for OTC Bond Transactions.

5. Reference Statistical Prices (Yields) for OTC Bond Transactions (2)

To provide reference information on bond prices, the JSDA publishes Reference Statistical Prices (Yields) for OTC Bond Transactions each business day based on the values of quotations for trades with a face value of roughly ¥500 million reported as of 3:00 p.m. by Designated-Reporting Members (securities companies and banks registered as members of the JSDA). This publication system serves as an important infrastructure widely used by investors and market participants. With calls for further increasing the reliability of this publication system, however, the JSDA made revisions primarily to the corporate bond part of the system and began operating the new system in November 2015.

Major enhanced elements in the new system are as follows.

(1) Stricter designation standards for Designated-Reporting Members: Recognizing the need to appoint members with the capability to report appropriate quotations that reflect movements of the corporate bond market as Designated-Reporting Members in order to increase reliability of Reference Statistical Prices (Yields) for OTC Bond Transactions, stricter designation standards, such as the member's trading volume of corporate bonds, etc. must be within the top 20, were added.

(2) Enhancement and reinforcement of guidance and management structure at the JSDA: To ensure that proper reporting is made by Designated-Reporting Members, the JSDA performs checks to detect (i) any inappropriate quotations for each business day and (ii) any problems with the reporting system of each Designated-Reporting Member.

(3) Revised calculation method for Reference Statistical Prices (Yields) for OTC Bond Transactions: When the reported corporate bond quotations are relatively dispersed and there is a major movement on the market, quotations that deviate significantly from the average quote may actually be more appropriate, and because abnormal values are eliminated in the checking performed in (2), it was decided that truncating the highest and lowest values of reported quotations, which was previously done mechanically, would no longer be performed.

(4) Pushing back the time of reporting deadline and the time of announcement: This change was in consideration of non-reporting members who voiced the need to push back the time of reporting deadline for reporting bond quotations in order to become reporting members.

(5) Promoting better understanding of Reference Statistical Prices (Yields) for OTC Bond Transactions: Easier-to-understand explanations on the nature, etc. of Reference Prices for OTC Bond Trading, e.g., Reference Statistical Prices (Yields) are values of mid-price quotations for buys and sells, are pro-

Chart VI-3. Illustrated Flow of Procedure up to the Publication of Reference Statistical Prices (Yields) for OTC Bond Transactions

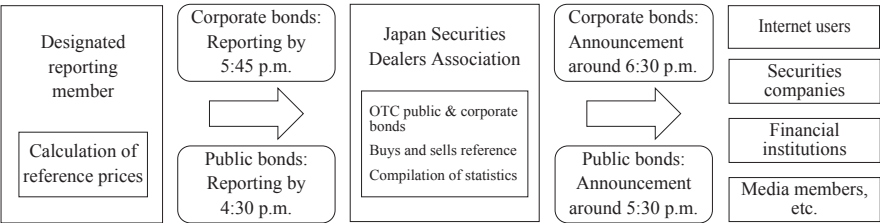


Table VI-6. Designation of Designated-Reporting Members

<p>The Japan Securities Dealers Association screens members intending to become Designated-Reporting Members based on the following designation standards to specify Designated-Reporting Members.</p> <p>(1) The member understands the purport of the System for Dissemination of Reference Statistical Prices (Yields) for OTC Bond Transactions and intends to become a Designated-Reporting Member.</p> <p>(2) The member is well versed in the operations for OTC bond trades.</p> <p>(3) The member has in place an organizational structure and staffing required for properly executing the operation for reporting quotations.</p> <p>(4) Other matters set forth by the JSDA.</p> <p>*For further details on screening standards, please see the website of the JSDA.</p>
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vided on the JSDA website, etc.

6. Reporting & Announcement System of Corporate Bond Trading

Recognizing the importance of increasing transparency of information on corporate bond prices and securing reliability through providing bond trading data in an aim to vitalize the corporate bond market, the JSDA decided to publicize actual trading prices of corporate bond trades on the OTC market from November 2015.

This new initiative is composed of the JSDA’s system to receive reporting on transaction prices, etc. from member securities companies and the system to disclose the reported transaction prices, etc.

(1) System of reporting corporate bond transaction information: The JSDA set out reporting requirements in its Self-Regulatory Rules against securities companies (JSDA members) when they are on one side of a bond transaction. Reporting is required for the following bonds: (i) bonds are subject to public offering or secondary distribution in Japan, (ii) bonds are issued in Japan, (iii) all the principal, interest, and redeemed principal are yen-denominated (ex-

Table VI-7. Revisions to Reference Statistical Prices (Yields) for OTC Bond Transactions

Revision measures	Outline	Revisions to bonds applicable to reporting
(1) Stricter designation standards for Designated-Reporting Members	<p>Added the following specific standards in acknowledging that the member is “well versed in the operations for OTC bond trades,”</p> <ul style="list-style-type: none"> · A Designated-Reporting Member that reports quotations on corporate bonds, etc. shall be ranked within the top 20 in terms of the bond trading volume. · However, reporting may be made for bond trades for which the member serves as the lead managing underwriter. 	Corporate bonds, TMK bonds, yen-denominated foreign bonds
(2) Enhancement and reinforcement of guidance and management structure at the JSDA	<ul style="list-style-type: none"> · Adoption of a process to check the reported quotations (including warnings issued to Designated-Reporting Members) every business day · Adoption of a process to check the reporting systems of Designated-Reporting Members · Setting self-regulatory regulation of prohibiting information exchange, etc. relating to quotation standards between Designated-Reporting Members 	All debt securities
(3) Revisions to the method of calculating reference statistical prices for OTC bond transactions	<ul style="list-style-type: none"> · Removal of the step to cut off the highest and lowest quotations reported 	Corporate bonds, TMK bonds, yen-denominated foreign bonds
(4) Pushing back the time of reporting deadline and the time of announcement	<ul style="list-style-type: none"> · Pushed back the time of reporting deadline by 1 hour and 15 minutes to 5:45 p.m. · Pushed back the time of announcement by about 1 hour to 6:30 p.m. 	Corporate bonds, TMK bonds, yen-denominated foreign bonds
(5) Promoting better understanding of reference statistical prices (yields) for OTC bond transactions	<ul style="list-style-type: none"> · Easier-to-understand explanations on the nature, etc. of reference statistical prices (yields) for OTC bond transactions, such as the possible deviation from actual trade prices, on the JSDA website, etc. 	All debt securities

cluding short-term corporate bonds and corporate bonds with subscription rights/warrants). Transactions subject to reporting include the following: (i) transactions that are reported every business day (trades with a face value of ¥100 million or above) and (ii) transactions that may be reported on a monthly basis if notified to the JSDA (trades with a face value of less than ¥100 million; provided, however, that transactions with a face value of less than ¥10 million may be omitted from reporting).

Chart VI-4. Illustrated Flow of Reporting & Announcement of Corporate Bond Trading

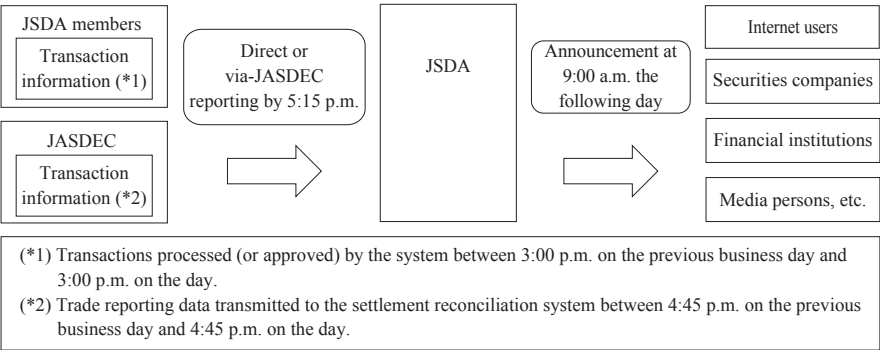
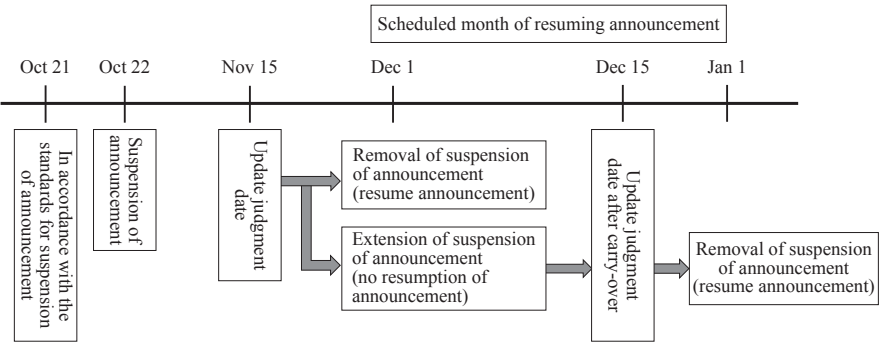


Chart VI-5. Information announced

○Announced on November 5, 2015
Trade contract date: November 4, 2015

Issue code	Issue name	Redemption date	Coupon rate	Transaction volume (face value basis) of ¥500 million or above	Transaction volume (face value basis) of less than ¥500 million	Contracted unit price (¥)	[Reference] Reference Statistical Prices (Yields) for OTC Bond Transactions (Average Prices)
000039023	XX Industries 3	2016/09/20	1.9	✓		102. --	102.09
					✓	102. × ×	
					✓	102. ● ●	

Chart VI-6. Example of suspension of announcement and removal of suspension of announcement



(2) System of publicizing corporate bond transaction information: The JSDA sets a standard of publicizing information on corporate bonds with “a rating of AA or its equivalent and above” and discloses information on bond trades (limited to trades with a face value of ¥100 million or above) on its website on the business day following the day on which reports on trades are received. Items reported are: (i) contract date, (ii) issue code, (iii) name of issue, (iv) due date, (v) coupon rate, (vi) trading value (face value is ¥500 million or above, or not), and (vii) unit price (unit price per face value of ¥100).

When certain conditions apply, the announcement of such corporate bond transaction is suspended.

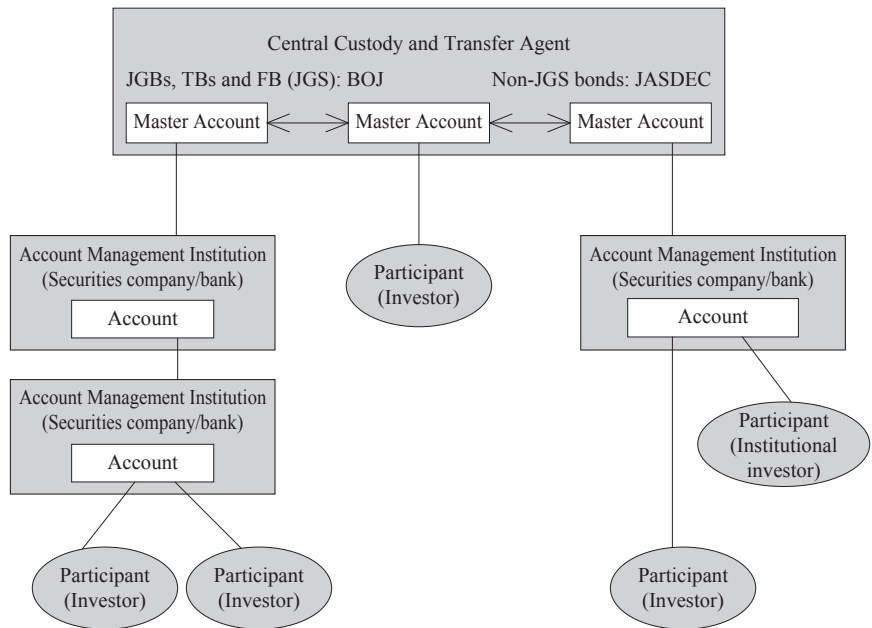
(3) Periodical verification: The JSDA has decided to periodically verify the impact, etc. of the implementation of the system of publicizing corporate bond transaction information on the liquidity of corporate bonds and to consider revising the system if needed.

7. Book-Entry Transfer System for Bonds

In the past, investors have held bonds in various forms—more specifically, in physical certificates that had been issued by the issuer; in registered form, where bondholders are registered on the registry at the registrar designated for the issue; and as book-entry JGBs, where physical certificates are deposited with the BOJ so that trades can be settled by book-entry transfers (within a system established in 1980) among the accounts of brokers and other system participants (account management institutions).

In recent years, however, with the increasing bond trading volume and a growing call for a flexible framework and an expedited process for the settlement of transactions, certificates, which need to be physically delivered, or registered bonds, whose transfer requires amendment in records of bond-specific registries, hardly stood the test of practical use, while the book-entry transfer system for JGBs had several shortcomings. This situation first led to the argument for the review of the current settlement procedures for bonds and, later, for the complete overhaul of the securities settlement system in Japan. There was a growing perception that Japan urgently needed to renovate the existing system to create a safer and more efficient infrastructure that would make the country’s securities markets globally competitive. Against this background, the securities settlement system reform law was enacted in June 2002, and, pursuant to its provisions, the existing legislation for book-entry transfer was later amended and renamed the Act on Book Entry of Corporate Bonds and Shares with objectives including the complete dematerialization of securities, the shortening of settlement cycles, and the reduction in settlement risk. The amended law provided for the legal framework of new

Chart VI-7. Structure of Book-Entry Transfer System for Bonds



book-entry transfer systems for corporate and government securities. On the basis of that framework, the BOJ renovated the existing JGB book-entry system in January 2003, and the Japan Securities Depository Center (JASDEC) started operating a new central custody and book-entry transfer system for securities, including nongovernment bonds in January 2006.

These book-entry transfer systems have a multitier, tree-like structure, with a central custody and transfer agent—the BOJ in the case of JGBs, TBs, and FBs and JASDEC, in the case of the other eligible securities—on the top tier, from which account management institutions, securities companies, and other institutions with respective master accounts in the system and system participants, other securities companies, and investors that have an account at one of the account management institutions cascade down as subsequent tiers or branches. Bond holdings of system participants are registered or recorded in the transfer account book kept by the account management institution at which they have an account. In principle, all bonds are deposited with the central custody agency at the time of issuance, and the entire issue is dematerialized. None of those book-entry bonds may be withdrawn over their life in the form of either physical certificates or registered bonds.

The previously mentioned Securities Settlement System Reform Law also

Table VI-8. Bonds under Custody and Book-Entry Transfer Volume

(No. of transactions, millions of yen)					
		Increase: Underwriting new issues	Decrease: Redemptions and retirement by purchase	Transfer	Number of participating issues (at fiscal year-end) Account balance
FY2007	No.	33,245	15,128	484,041	72,817
	Amount	40,491,108	12,840,198	240,536,068	241,002,170
FY2008	No.	33,961	38,830	492,394	73,298
	Amount	37,812,077	38,539,738	223,475,737	240,274,559
FY2009	No.	31,642	38,176	411,272	71,202
	Amount	38,124,350	32,846,953	132,878,030	245,552,257
FY2010	No.	29,501	36,849	439,327	67,788
	Amount	37,212,947	32,691,251	146,347,996	250,073,952
FY2011	No.	26,664	35,619	439,867	60,701
	Amount	32,955,046	30,589,808	156,713,049	252,439,190
FY2012	No.	27,326	33,476	471,798	58,486
	Amount	33,558,410	33,213,581	143,537,681	252,784,020
FY2013	No.	26,726	31,642	437,387	55,595
	Amount	34,446,614	34,030,438	135,561,923	253,200,196
FY2014	No.	25,761	32,082	465,813	54,294
	Amount	33,410,427	34,831,065	158,293,806	251,779,558
FY2015	No.	25,722	30,604	524,130	53,825
	Amount	31,146,061	32,462,918	204,529,981	250,462,702
FY2016	No.	27,401	28,040	349,226	58,288
	Amount	41,737,175	35,052,475	131,163,539	257,147,401

Note: The JGB book-entry system began on January 10, 2006.

Source: Japan Securities Depository Center (JASDEC)

provided measures to abolish the Corporate Bond Registration Law following the setup of the book-entry transfer systems.

8. Bond Yield and Terms of Issuance

Those who raise funds (fund raising party) by issuing bonds look for a method that offers the lowest possible cost. On the other hand, investors who buy

Table VI-9. Reforms of Bond Delivery and Settlement System

Month/Year	Changes implemented
April 1994	Delivery versus payment (DVP) of government bonds through the Bank of Japan network starts.
April 1977	System of T+3 government bond rolling settlement starts.
October 1999	System of T+3 general bond rolling settlement starts.
January 2000	Real-time gross settlement (RTGS) of government bonds starts.
January 2003	Act on Book Entry of Corporate Bonds and Shares (stipulating paperless trading in bonds, etc.) is enforced. Paperless trading in government bonds starts.
May 2004	DVP trading in bonds other than government bonds starts.
May 2005	Trading in government bonds through a settlement organization starts.
January 2006	Paperless issuance of and paperless trading in bonds other than government bonds starts.
April 2012	Settlement of JGBs scheduled to be shortened (T+2)
May 2018	Scheduled timing of enforcing shortened settlement of JGBs (T+1)

bonds choose issues that offer the highest possible return within the range of tolerable risk. In theory, the issue terms of a new bond (subscriber's yield to maturity) are determined at a certain level where opportunities for arbitraging its subscriber's yield to maturity and the secondary market yield (yield to maturity) of outstanding issues of a nature similar to that of the bond are balanced. When such a point of balance is achieved, it is said that "issue terms that adequately reflect the secondary market conditions have been established." Important conditions for efficient arbitrage to occur include the following: the outstanding balance and trading volume of comparable bonds are sufficiently large, new bonds are issued regularly, and the secondary market yields of comparable bonds are available for reference at the time of pricing new issues. It can be said that in the Japanese bond market yields at the issue of bonds have come into line with yields of comparable bonds as the amount of new issues of the bonds and secondary trading volume of such bonds increased.

More specifically, while JGBs had been issued through the underwriting syndicate program for smooth and stable financing, the proportion of bond issuance through competitive bidding that more closely reflect market conditions has steadily increased under a market-oriented national debt management policy, replacing the previous emphasis on non-competitive, syndicated underwriting, where issue terms were based on the official discount rate or other benchmarks. Currently, in principle, all government bonds (excluding those for retail investors) are issued through auctions (the syndicated under-

Chart VI-8. Changes in Issue Terms (Yields) of Bonds

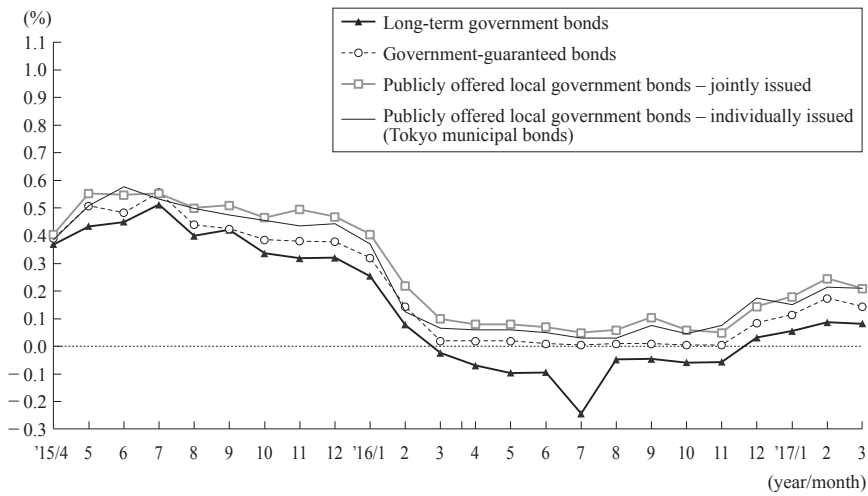
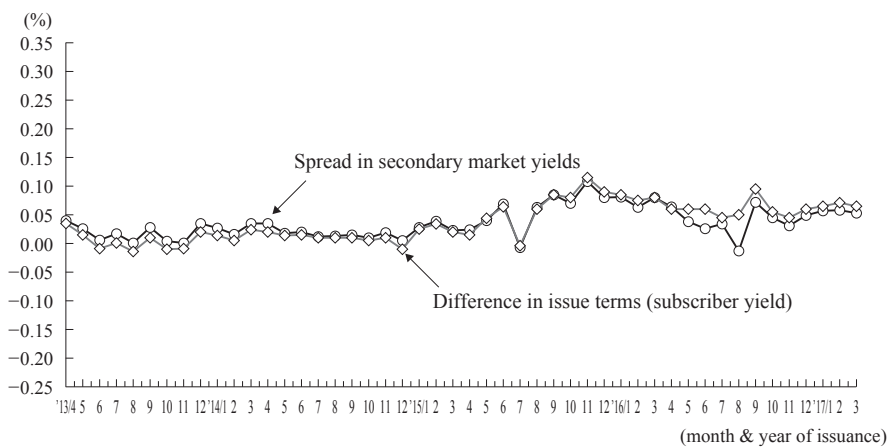


Chart VI-9. Changes in the Difference in Issue Terms and Secondary Market Yields between Publicly Offered, Jointly Issued Municipal Bonds and Government-Guaranteed Bonds



Notes: 1. Spread in secondary market yields is the difference in reference prices of OTC traded public and corporate bonds (average value: simple interest) on the day prior to the term determination date of jointly issued local government bonds and of government guaranteed bonds (10-year long-term).
2. Difference in issue terms (subscriber yield) is jointly issued local government bonds minus government guaranteed bonds (each 10-year bonds).

writing program for JGBs was discontinued in March 2006).

The market-oriented transition of bond issuance has also been witnessed in pricing spreads among bonds with different credit qualities. For example, yields at the issue of government-guaranteed bonds and local bonds were determined in reference to the yield at issue of 10-year JGBs that had been issued earlier in the month. From time to time in the past, the spreads of issues among the three classes of bonds deviated from market spreads. In recent years, however, as investors started to focus more on differences in credit quality, the spreads of issues among the three classes have increasingly tended to move more in line with credit spreads prevailing in the market. Another case in point that demonstrates the increased market orientation in bond issuance is that a growing portion of government-guaranteed bonds is now issued through a competitive bidding process (as individual issues). Investors are also showing an increasing tendency to differentiate corporate bonds based on credit ratings by rating agencies and other factors. In response to this, many issuers go through a premarketing process to identify and estimate investors' demand and determine the terms of issue accordingly.

9. *Gensaki* Market for Bonds (1)

A repurchase agreement (*gensaki* transaction) (a conditional purchase or sale) is a form of trading between a seller and a buyer of bonds whereby the seller (or the buyer) agrees to repurchase (or resell) the securities at an agreed-upon price at a stated time. When the holder of bonds sells them to a buyer under an agreement to buy them back (a *gensaki* sell transaction), the holder can raise funds temporarily. When an investor buys bonds from a seller under a repurchase agreement to sell them back to the seller (a *gensaki* buy transaction), the investor can earn a certain amount of interest by investing funds for a short period. When a securities company, etc. acts as an intermediary and arranges a repurchase agreement (*gensaki* transaction) by introducing a buyer which wants to invest idle cash in bonds to a seller which wants to raise funds by selling bond holdings, such a deal is called a brokered repurchase agreement. When a securities company, etc. that is in need of short-term cash sells bonds out of its inventory to an investor under a repurchase agreement, it is called a proprietary repurchase agreement. As the repurchase (or resale) price includes an amount equivalent to a return on investment or financing charge based on an agreement by the buyer and seller, the price does not usually tally with the market price of the bond prevailing at the time of its repurchase (or resale). Repurchase agreements (*gensaki* transactions) can also be concluded for commercial paper (CP) and certificates of deposit (CDs), CPs issued overseas, etc.

Chart VI-10. Working Mechanism of Bond Lending (secured with cash deposit)

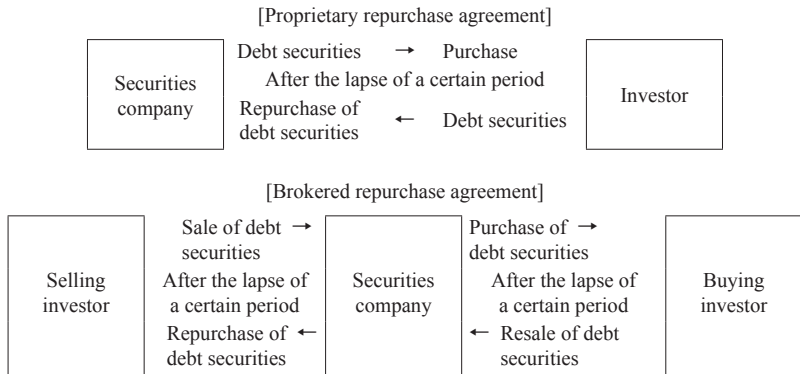


Table VI-10. Turnover and Balance of Bond Repurchase Agreements (*Gensaki*)

(¥10 billion, %)

FY	Turnover of bonds (A)	Turnover of repurchase agreements (B)	B/A	Balance of repurchase agreements
2007	1,253,438	905,505	72.2	4,953
2008	1,051,186	724,941	69	2,326
2009	790,513	459,243	58.1	1,589
2010	772,195	424,664	55	1,518
2011	840,802	471,756	56.1	2,538
2012	852,118	503,564	59.1	2,354
2013	946,008	627,538	66.3	2,641
2014	1,050,441	706,429	67.3	3,079
2015	1,039,539	758,277	72.9	3,053
2016	928,393	691,841	74.5	3,344

Source: Japan Securities Dealers Association.

Despite some annual fluctuation, *gensaki* transactions have maintained a significant level of trading volume because they conveniently meet the short-term funding and cash management needs of investors. The outstanding balance of *gensaki* transactions reached almost ¥50 trillion at the end of fiscal 2007, compared with ¥7 trillion in the latter 1980s. Although there have been some dips in the balance since then due primarily to the effects of the global financial crisis, the balance turned upward in 2010 and since has been at the

Table VI-11. Balance of Bond Repurchase Agreements, by Major Investor Group

(¥10 billion)

	FY2007		FY2008		FY2009		FY2010		FY2011		FY2012		FY2013		FY2014		FY2015		FY2016	
	Selling balance	Buying balance	Selling balance	Buying balance	Selling balance	Buying balance	Selling balance	Buying balance	Selling balance	Buying balance	Selling balance	Buying balance	Selling balance	Buying balance	Selling balance	Buying balance	Selling balance	Buying balance	Selling balance	Buying balance
Trust banks	0	18	0	8	0	68	0	88	0	97	0	13	0	0	0	2	0	0	0	0
Other banking institutions	21	15	15	26	0	12	0	3	0	111	0	86	0	56	3	4	0	0	5	0
Investment Trusts	0	92	0	92	0	75	0	65	0	143	0	206	0	84	0	33	0	0	0	0
Corporations	3	31	0	31	0	47	0	43	0	82	0	50	0	31	0	25	0	4	0	3
Entities not domiciled in Japan	1,960	1,760	678	466	446	446	538	560	616	1,200	511	1,293	588	1,759	865	1,951	754	2,228	572	2,373
Others	179	874	173	1,006	210	496	155	220	121	288	70	196	55	122	99	188	66	46	384	55
Bond dealers	2,790	2,163	1,460	697	933	446	825	539	1,800	618	1,772	511	1,998	588	2,111	876	2,233	774	2,383	914
Total	4,953	4,953	2,326	2,326	1,589	1,589	1,518	1,518	2,538	2,538	2,354	2,354	2,641	2,641	3,079	3,079	3,053	3,053	3,344	3,344

Source: Japan Securities Dealers Association.

¥30 trillion level.

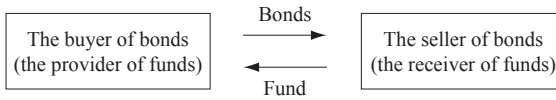
Previously, the overwhelming majority of *gensaki* transactions were for short-term government securities (TBs and FBs). Despite intensifying competition against other increasingly diversified money market instruments these government bills have dominated the *gensaki* market, as the bills, which have maturities and credit quality more suitable for *gensaki* transactions, have been increasingly issued to the public. More specifically, these short-term government securities dominated the market because (1) in 1986 the BOJ stopped reselling FBs that it had underwritten in the secondary market, shifting this operation to the *gensaki* market; (2) since 1999 the government has been issuing all FBs, in principle, directly to investors through public auctions; (3) the TB program got started in 1986; and (4) the issuance of both TBs and FBs has been regular and of large volume. Although the *gensaki* market developed primarily against the backdrop of this expansion of the short-term government securities market, interest-bearing JGBs have taken center stage in recent years, partially because of the massive overall issuance of government bonds.

10. *Gensaki* Market for Bonds (2)

In an effort to modernize and strengthen the international competitiveness of Japan's money market, the *gensaki* market underwent a reform to improve its

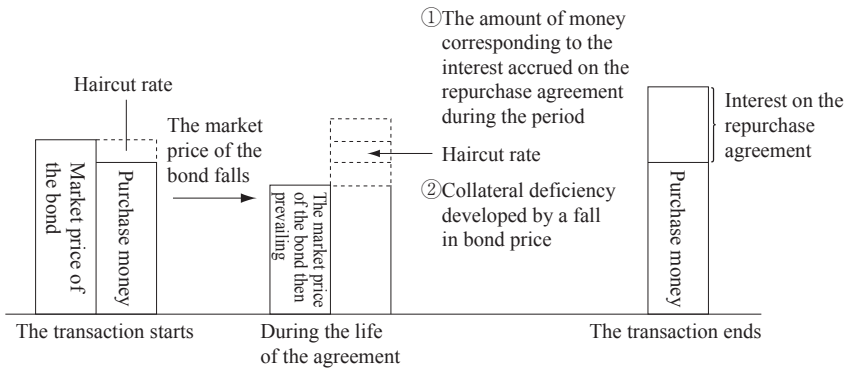
Chart VI-11. Working Mechanism of the New *Gensaki* Transaction System

1. Start of transaction



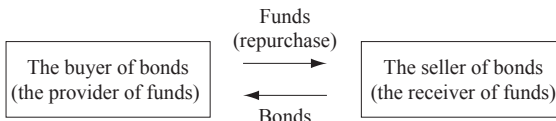
- Purchase money for bonds
The market price of the bonds prevailing at the time a deal is struck $\div (1 + \text{haircut rate}) \times \text{number of bonds traded}$

2. Control of credit risk during the life of the agreement



- Credit given to the seller of the bonds by the buyer of the bonds (the provider of funds) = ① + ②
- In the case referred to above, the buyer of the bonds can demand collateral (cash and/or bonds) of the seller, the value of which is equal to the credit given him (margin call).

3. End of transaction



- Money to repurchase the bonds is necessary for the seller at the time the transaction is consummated.
- The money of the buyer is needed to purchase the bonds at the time the transaction started + interest accrued on the repurchase agreement.

functions as a repo market that facilitates the need for both short-term financing and bond borrowing, and thus what came to be called new *gensaki* transactions started in April 2001. Up to that point, *gensaki* transactions were bought and sold much like the transactions commonly known as repo trades in the U.S. and Europe but had various shortcomings that cried out for reform. In particular, the *gensaki* market did not have functional risk management facilities or standard rules for dealing with counterparty default. By this reform, new measures were instituted and existing provisions were enhanced for risk management and other purposes, establishing the *gensaki* market in accordance with global standards.

The newly introduced provisions for risk management and other purposes (clauses in the repurchase agreement) may be summed up as follows:

(1) Risk control clause:

The amount of collateral (bonds) shall be adjusted flexibly so as not to cause a shortage of collateral on account of a fall in the price of bonds submitted as collateral.

(i) Application of the ratio for computing the purchase/sale value of bonds (the haircut clause): Under this clause, the unit price of bonds (collateral), on the basis of which a repurchase agreement is concluded, is fixed at a level that is a certain percentage point lower than the price prevailing at the time the repurchase agreement is concluded, so that the value of the collateral will not be affected even when the market price of the underlying bonds falls.

(ii) Application of a margin call clause (collateral management, etc.): Under this clause, when the market value of the underlying bonds changes during the period of the repurchase agreement, the amount of credit extended to a party to the repurchase agreement is maintained by adjusting the collateral so that the market value of the bonds agrees with the amount of funds.

(iii) Application of repricing: In a case in which the market price of the underlying bonds falls sharply from that which prevailed at the time of the repurchase agreement, the parties to the agreement agree to cancel the agreement and renegotiate a new agreement on the basis of the price then prevailing, on terms and conditions identical to those of the agreement thus canceled.

(2) Substitution of underlying bonds:

Under this clause, the seller of bonds can replace the underlying bonds with other bonds with the consent of the buyer, allowing the seller to use the underlying bonds if necessary.

(3) Institution of a netting-out system:

If the other party goes into default for any reason, such as bankruptcy, the value of all transactions covered by the agreement will be reas-

essed based on market prices, and the difference between claims and obligations will be settled.

11. Bond Lending

When investors have shorted bonds (or sold bonds that they do not own) and failed to buy them back before the settlement date, they turn to bond lending services to borrow bonds to deliver. When the collateral is cash, bond lending is also used to procure or invest money on a short-term basis similar to *gensaki* transactions.

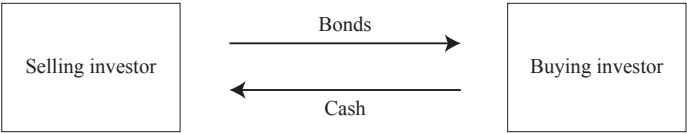
Since market participants can obtain bonds through bond lending facilities after trades are consummated, they can sell bonds that they do not own (sell short) when they feel that the bond market is too expensive or particular issues are overvalued. Such operations contribute to greater liquidity in the market.

Bond lending was instituted by legislation in 1989, following the lifting of the practical ban on bond short selling. In fear of potential effects on the financial soundness of brokers and dealers and bond pricing, market participants had previously been requested to refrain from selling bonds short. The ban, however, was lifted to help encourage active market making in cash bonds, and arbitrage between cash bonds and futures and bond borrowing and lending was introduced as one of the means to locate bonds to deliver. Initially, cash collateral bond borrowing and lending was restricted in light of potential conflicts with the *gensaki* market and other considerations, and, subsequently, most transactions were uncollateralized. However, with credit fears rising, the bond lending market remained stagnant and cash collateral bond borrowing and lending transactions were effectively deregulated in 1996 in order to invigorate the market.

When viewed from a legal standpoint, a bond lending transaction is deemed to be a contract for a loan for consumption. A borrower borrows bonds for the purpose of consumption and, when due, the borrower has only to return bonds identical in kind and quantity with those originally borrowed. Bond lending transactions may be broadly classified into “secured transactions” and “unsecured transactions” depending on whether they are collateralized or not. Secured bond lending transactions may be further divided into “cash-collateralized transactions” and “securities-collateralized transactions” by the type of collateral being pledged. Cash-collateralized transactions used to borrow specific bond issues are called SC *torihiki* (specified collateral trades), while those for financing and cash management without such specification are termed GC *torihiki* (general collateral trades). The size of the bond lending market (in terms of the balance of outstanding loans) has generally

Chart VI-12. Trading Mechanism of Repurchase Agreements

[Proprietary repurchase agreement]



[Brokered repurchase agreement]

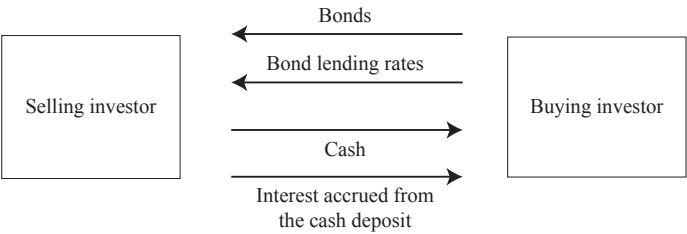


Table VI-12. The Balance of Bond Lending Transactions, by Type of Collateral (on the basis of delivery and face values)

(¥10 billion)

	Bonds lent				Bonds borrowed			
	Secured transactions	Secured by cash deposit	Unsecured transactions	Total	Secured transactions	Secured by cash deposit	Unsecured transactions	Total
FY2007	9,478	8,669	395	9,872	9,944	9,664	667	10,611
FY2008	6,863	6,679	246	7,109	6,863	6,679	246	7,109
FY2009	8,227	8,005	275	8,502	8,227	8,005	275	8,502
FY2010	7,333	7,128	284	7,617	7,333	7,128	284	7,617
FY2011	8,296	8,286	207	8,503	8,296	8,286	207	8,503
FY2012	8,239	8,200	227	8,467	8,239	8,200	227	8,467
FY2013	10,085	9,984	267	10,352	10,085	9,984	267	10,352
FY2014	10,483	10,310	322	10,805	10,483	10,310	322	10,805
FY2015	9,680	9,454	450	10,130	9,680	9,454	450	10,130
FY2016	12,316	12,178	428	12,744	12,316	12,178	428	12,744

Note: Breakdowns of bond lending transactions have been published since January 1997. A partial revision was made to the calculation method in January 2009.

Source: Japan Securities Dealers Association.

been growing since cash-collateralized transactions were deregulated in 1996. The market has grown from approximately ¥34 trillion at the end of fiscal 1996 (including approximately ¥17 trillion in cash-collateralized transactions) to ¥127 trillion at the end of fiscal 2016 (including approximately ¥122 trillion in cash-collateralized transactions). The majority of bond lending transactions are conducted with government securities.

CHAPTER VII

Investment Trusts

1. Overview

An investment trust is a financial instrument that raises money from two or more investors in order to establish a large fund that it invests in regarding a variety of assets, such as stocks and bonds, under the management of an investment specialist, and the profits earned through that investment are then distributed among the investors in proportion to their contributions.

An investment trust allows investors to indirectly enter various asset markets even with a small amount of money as well as to enjoy the benefits of scale economies and efficient diversified investment that are generated through a joint investment with other investors, also allowing them to take advantage of information analysis and investment sophistication gained by having the investment managed by specialists. The repayment of the principal of an investment trust is not guaranteed, because its earnings depend upon its performance. There are a variety of investment trusts depending on investment instruments and methods, including one that is similar to deposit and savings accounts and another that is like derivatives trading in that it aims at achieving higher earnings by assuming higher risks.

The overall structure of the Japanese investment trust system is stipulated in the Act on Investment Trusts and Investment Corporations. Regulations concerning the actions of investment trust management companies, the key players in the management of investment trusts, are defined in the Financial Instruments and Exchange Act. Investor protection is also provided by self-regulatory rules established by The Investment Trusts Association, Japan (JITA), an approved self-regulatory organization under the Financial Instruments and Exchange Act.

Investment trusts play a major role in making investments for the general public and have the economic benefit of helping companies to raise money by bringing in the funds of the general public on the securities market. They also perform the function of contributing to the reasonable determination of prices in the securities markets as an institutional investor.

Chart VII-2 shows the growth of the total net assets of publicly offered in-

Chart VII-1. Investment Trust Concept

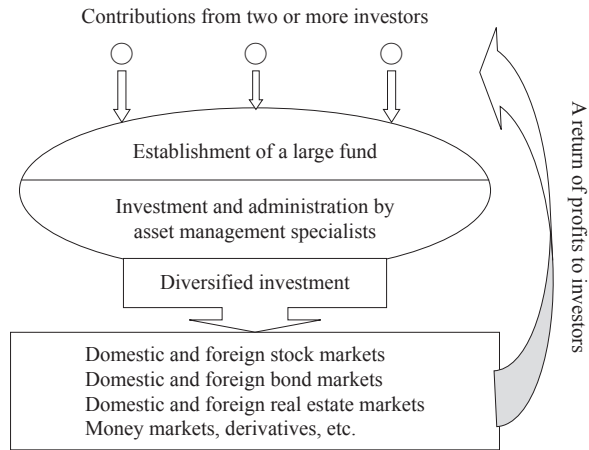
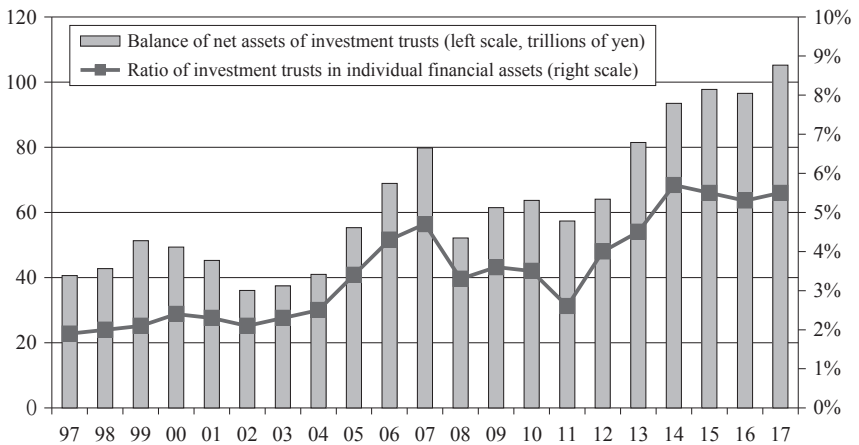


Chart VII-2. Trend of Total Net Assets of Publicly Offered Investment Trusts and Their Positions



Note: Figures for 2017 are as of the end of September (percentages in individual financial assets are as of the end of June).

Source: Balance of net assets of investment trusts: the Investment Trusts Association, Japan; ratio of investment trusts in individual financial assets: Bank of Japan "Flow of Funds Accounts".

vestment trusts over the past 20 years in Japan. The market declined after the burst of the bubble economy but rebounded temporarily around 2005 along with the recovery of the stock market encouraged by a heightening of investment awareness among the people of the country in an ultralow-interest-rate environment. The market fell again, a drop of 35% year on year, following the global financial crisis in 2008. Nevertheless, the decline in the market bottomed out in January 2009 and topped the ¥100 trillion level for the first time in May 2015. Still, as of the end of 2016, Japan accounted for only 2.2% of the net assets total of the world's publicly offered investment trust of more than \$36.8 trillion (¥4,300 trillion), a small portion compared with Japan's approximately 6% share of the world gross domestic product (GDP). This suggests that there is high growth potential for investment trusts in Japan, so it is expected that investment trusts will grow as a core product, accelerating the shift from "saving" to "asset-building" in the future.

2. History of Investment Trusts

The investment trust, a collective investment scheme, has proved popular in both developed countries as well as emerging countries in various forms since its inception in the U.K. in the late nineteenth century.

In Japan, investment trusts existed before the war, but the current system began with the enforcement of the Securities Investment Trust Act in June 1951. It was not naturally generated from demands from investors as in the West but was politically introduced for a supply-and-demand adjustment of stocks substantially released as a result of the break-up of the *zaibatsu* financial combines (democratization of securities) and in order to raise money for revivifying industries during the postwar period, when there was a severe lack of funds. Legislated in reference to the prewar investment trust, it was launched in the form of the unit-type stock investment trust (contractual type).

The Securities Investment Trust Act was partially amended in 1967 after the securities crisis, to establish the code of conduct for investment trust management companies; to clarify the fiduciary duty of investment trust management companies to beneficiaries (persons who process operations for others in trust are required to act only for the benefit of the others); and to adopt and strengthen provisions on prohibited activities. In 1995, a major reform was conducted, mainly for the purpose of advancing deregulation and greater disclosure.

The large amendments to the law made in 1998 were associated with implementation of the Act on Revision, etc. of Related Acts for the Financial System Reform under "free, fair, and global" principles. As a result of the

Table VII-1. History of the Investment Trust in Japan (Post-war)

System	Products	Marketing	Management
The Securities Investment Trust Act was implemented (1951)	Investment trusts were launched in the form of unit-type investment trusts (1951)	Investment trusts became available at securities companies	Assets were invested mainly in domestic stocks
	Open-type investment trust was launched (1952)		
Investment trust management business was separated from securities companies (beginning operations in 1960)	Bond investment trusts were established (1961)		The weight of domestic bonds substantially increased (1961)
The Securities Investment Trust Act was amended to add provisions for the duty of loyalty of investment trust management companies to beneficiaries and the duty of disclosure, etc. (1967)			
		The marketing of foreign investment trusts in Japan was liberalized (1972)	Foreign securities began to be included in assets of investment trusts (1970)
Investment trust management companies entered the investment advisory business (1984)	The medium-term government bond investment trusts were established (1980)		
Foreign companies entered Japanese investment trust management business (1990)			
Bank affiliates entered investment trust management business (1993)	MMFs were established (1992)	Investment trust management companies started to sell investment trusts directly (1993)	
Investment trust reform was determined (1994) Reform was implemented in 1995	Nikkei 300 Exchange Traded Fund was established (1995)		Investment restrictions were deregulated, including utilization of derivatives for purposes other than hedging (1995)
Act on Revision, etc. of Related Acts for the Financial System Reform was implemented (1998)	Private placement investment trusts were launched (1999)	Banks and insurance companies started to sell investment trusts (1998)	
The Act on Investment Trusts and Investment Corporations was implemented (2000)	Corporation type investment trusts were established (2000)		Target of investment trusts expanded to a variety of fields, including real estate (2000)
Portfolio valuation method of bond investment trusts shifted to market value accounting (2001)	Real estate investment trusts were established (2001)	The Act on Sales, etc. of Financial Instruments was implemented (2001)	Some MMFs' net asset value fell below their principle amount (2001)
	In-kind contribution ETFs were listed (2001)	Sales of investment trusts started at post offices (2005)	
The Financial Instruments and Exchange Act was implemented (2007)			Target of investment trusts was expanded to commodities (2008) Credit risk regulations were introduced (2014)

Source: Author of the chapter

amendments, the corporation type investment trust, the mainstream in the U.S. and Europe, was introduced in Japan, where only the contractual type used to exist, from the standpoint of promoting the globalization of the investment trust business, deregulating the establishment of new funds by changing from an approval system to a filing system, and allowing investment trust management companies to outsource the management of the fund to outside companies. Distribution channels were also expanded to financial institutions, and banks became able to distribute investment trusts. Disclosure was enhanced by obligating investment trusts to meet disclosure requirements under the Securities and Exchange Act.

In 2000, investment objects were expanded to those other than securities. This allowed investment trust management companies to establish the “real estate investment trust.” The law was renamed “the Act on Investment Trusts and Investment Corporations,” deleting the word “Securities.” Amendments were made to include additionally the duty of due care of a prudent management (investment fund management companies are required to give instructions on asset management of investment trusts as good managers) in the rules of conduct for investment trust management companies.

In 2006, in relation to the enactment of the Financial Instruments and Exchange Act (implemented at the end of September 2007), the Act on Investment Trusts and Investment Corporations was amended to relegate provisions on the rules of conduct for investment trust management companies. Further, in 2014, risk regulations on managed assets were also introduced.

3. Forms of Investment Trusts

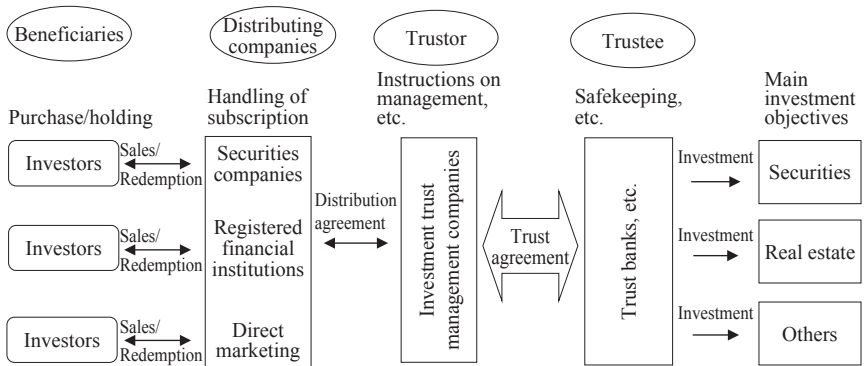
Investment trusts are broadly classified into the contractual type and the corporation type.

Contractual Type (Investment Trust)

Some contractual type investment trusts take such legal form as a trust or a common fund in most of the world; however, in Japan the contractual type investment trust takes the legal form of a trust and is subclassified into investment trusts with investment instructions from trustors or without investment instructions from trustors.

An investment trust with investment instructions from trustors consists of three entities: the trustor, the trustee, and the beneficiary. The trustor is an asset management company (investment trust management company) registered with the Financial Services Agency. It carries out product development, prepares a trust deed and files it with the authorities, and provides investment instructions to a trustee (it has the authority to outsource the investment in-

Chart VII-3. The Operating Structure of Investment Trusts with Instructions from Trustors



Source: Partially adjusted flowchart from the Investment Trusts Association, Japan's report on "Investment Trusts in Japan 2014."

structions to outside companies). The trustee is a trust company or a bank concurrently engaging in the trust business of holding and administrating assets under investment trusts according to a trust agreement. Investors obtain the position of beneficiary by accepting a beneficiary certificate and receive the profits arising from investment management as dividends or by redeeming the certificate.

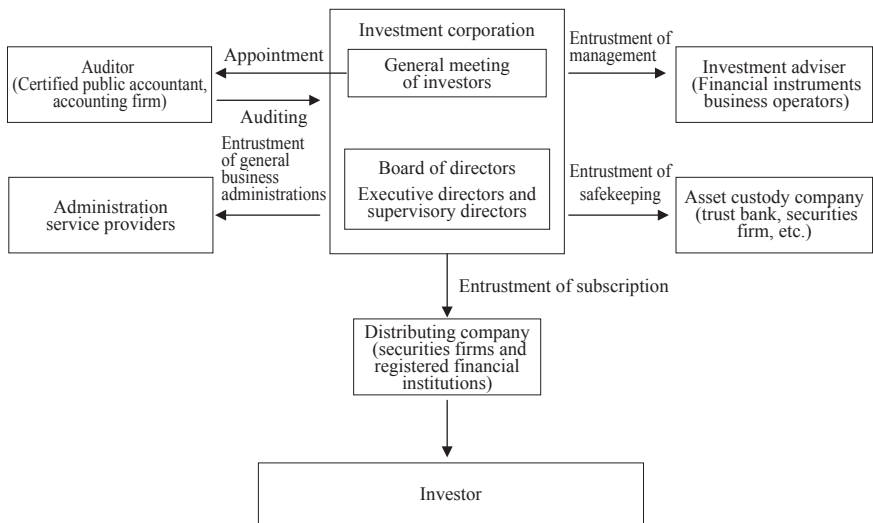
In the case of an investment trust without investment instructions from trustors, the trustee enters into a trust agreement with two or more investors and combines their funds into a trust asset, which is then invested mainly in specified assets excluding securities and held and administrated by the trustee without instructions from the trustors.

Chart VII-3 shows the structure of an investment trust with instructions from trustors which is generally adopted in Japan.

Corporation Type (Investment Corporation)

The corporation type is operated in a legal form that is similar to a corporation. In Japan, an investment corporation with a corporate veil is established and operated by officers who are appointed by an investors meeting, but it must entrust its business, such as asset management, custody of the fund's assets, general business administration, and the handling of subscriptions, to outside companies. Investors obtain the position of shareholder by accepting share certificates (investment certificates) issued by the investment corporation and receive the profits arising from the investment management as dividends. Chart VII-4 illustrates such a structure.

Chart VII-4. Operating Structure of Corporation Type (Investment Corporation)
Investment Trusts



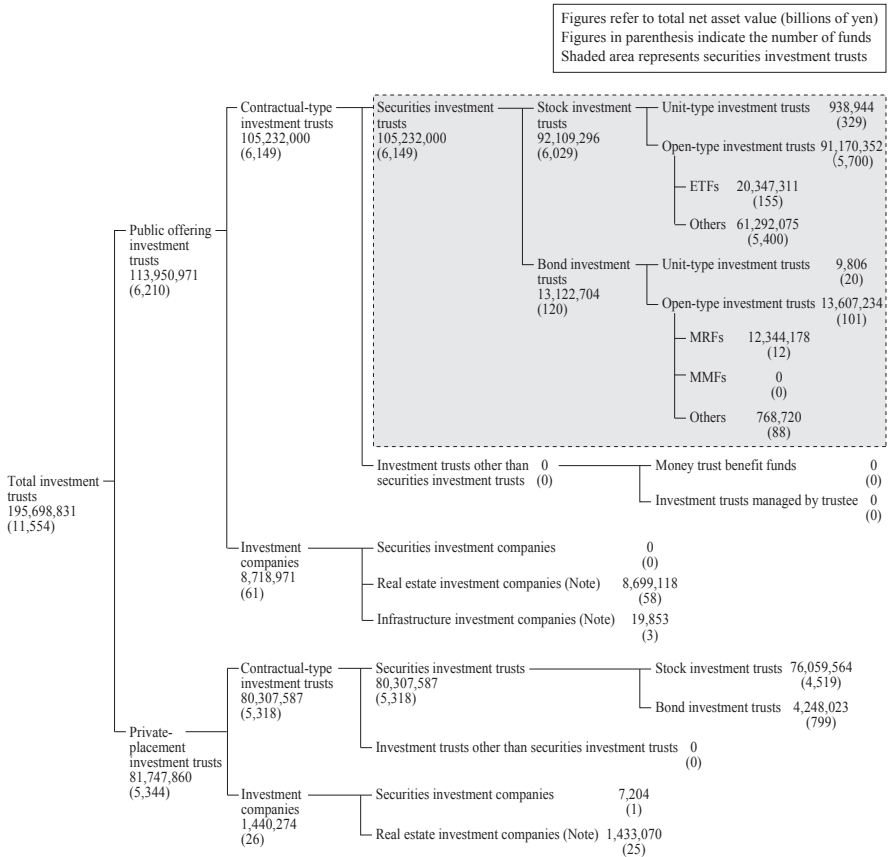
Source: The Investment Trusts Association, Japan, “Investment Trusts in Japan 2014.”

Both the contractual type and the corporation type of investment trusts in the world include the open-end type and the closed-end type. Which type they are grouped into depends on the claims of investors to redeem issued certificates. The open-end type accepts the beneficiary’s request and redeems the certificates at market price by selling trust assets, while the closed-end type does not accept the beneficiary’s request to redeem the beneficiary’s certificates. The latter ensures liquidity by listing its issued certificates. In Japan, contractual type investment trusts are principally of the open-end type, while corporation type investment trusts, in particular, real estate investment trusts, are of the closed-end type.

4. Investment Trust Products

The total net assets of broadly defined investment trust products amounted to ¥195 trillion in Japan as of the end of September 2017. They are classified by a variety of methods.

Chart VII-5. Overview of Investment Trusts (total net assets, number of funds)
As of September 30, 2017



Note: Figures on real estate investment companies and infrastructure investment companies are from the previous month.

Source: The Investment Trusts Association, Japan.

Public Offering of Investment Trusts and Private Placements of Investment Trusts

A public offering of investment trusts is offered to 50 or more unspecified investors, while a private placement is sold to Qualified Institutional Investors or specified investors stipulated in the Financial Instruments and Exchange Act or to fewer than 50 investors. Establishment of a private placement was made possible by the 1998 amendment to the Investment Trust Act. It has the margin to freely design products only with the approval of the investors, be-

cause a private placement is subject to less-rigid investment restrictions than a public offering. Therefore, privately placed funds attract the attention of large investors, in particular institutional investors, and rapidly increase in volume as funds invested in by variable annuities, etc.

Stock and Bond Investment Trusts

The Japanese tax laws define stock investment trusts as funds that hold even a small number of stocks, and bond investment trusts are funds that invest not in stocks but only in bonds. Bond investment trusts include funds that invest mainly in long-term bonds and Money Reserve Funds (MRF) that invest in short-term money market vehicles.

Unit-Type and Open-Type Investment Trusts

Unit-type investment trusts are funds that do not allow additional subscriptions after having accepted funds in principal value only during their initial subscription period, while open-end investment trusts are funds that do accept additional subscriptions at market value after their establishment. In Japan, investment trusts were launched in the form of the unit type, which was similar to savings instruments, in 1951; however, open-end investment trusts have currently become a mainstream financial instrument, just as in foreign countries.

Classification by Investment Object

The Investment Trusts Association, Japan, offers a product classification according to the object of investment of the funds, so that investors can select funds easily. The prospectus of funds clearly describes into which classification the funds fall.

Exchange Traded Funds (ETF)

Among open-type funds, funds whose net asset value fluctuates closely with securities price indexes, including the stock index, and whose units are listed and traded on exchanges like stocks are called ETF. (In the U.S., actively managed ETFs also exist.) They are formed by the in-kind contribution of stocks by designated participants and others, and the units/shares of many ETFs can be exchanged for the component stocks held in a timely manner. This creates arbitrage opportunities with the component stocks, a mechanism that keeps the gap between the traded prices of the fund on the exchange and the indexes targeted by the fund within a small range.

5. Sale of Investment Trusts

The subscription and sale of investment trusts had been practiced only by securities companies in Japan since the establishment of investment trusts in 1951. (Some investment trust management companies started direct marketing in the 1990s.) The entries of financial institutions, including banks, in 1998 and some post offices in October 2005 expanded the distribution network rapidly. As a result, there was a substantial change in the breakdown of the total net assets of investment trusts by distribution channel, as described in Chart VII-6. Financial institutions, including banks, accounted for 27% of public offerings of investment trusts and 31% of publicly offered stock investment trusts as of the end of September 2017. Banks had nearly an 80% share in private offerings of investment trusts. In contrast, investment trust management companies saw weak growth in direct marketing, partially due to the exit of large companies related to securities companies (as such companies absorbed the sales).

Investment trusts are generally available over the counter in distributing companies and through their sales agents. Recently, the number of online transactions has also grown. According to a survey conducted by the Investment Trusts Association, Japan, in 2015, 18.6% of all respondents answered that they had acquired investment trusts online.

Distributing companies are subject to the Financial Instruments and Exchange Act, Act on Sales, etc. of Financial Instruments and the regulations of the Japan Securities Dealers Association, and they are obliged to comply with the rules on sales of the Investment Trusts Association, Japan. For example, they must comply with the suitability rule, which requires distributing companies not to engage in inappropriate solicitation activities in light of customers' knowledge, experience, investment purpose, and assets and to assume "accountability" for risk factors, including market and credit risk, and for important portions in the structure of transactions and to maintain the "duty of sincerity to customers" not to conduct "prohibited activities" at the time of sale, such as providing conclusive evaluations. Depository institutions, such as banks, shall be required to take measures to prevent customers from mistaking investment trusts for deposits at the sale of investment trusts, including explaining that they are not covered by the deposit insurance system. As a part of the enhancement of accountability at the implementation of the Financial Instruments and Exchange Act in 2007, the "duty to deliver documents prior to the conclusion of a contract" was introduced. This duty, however, is not required when the eligible prospectus has been delivered to customers. For investment trusts, the requirement is satisfied by delivering the eligible prospectus.

Chart VII-6. Breakdown of Total Net Assets of Publicly Offered Stock Investment Trusts by Distribution Channel (As of September 30, 2017)

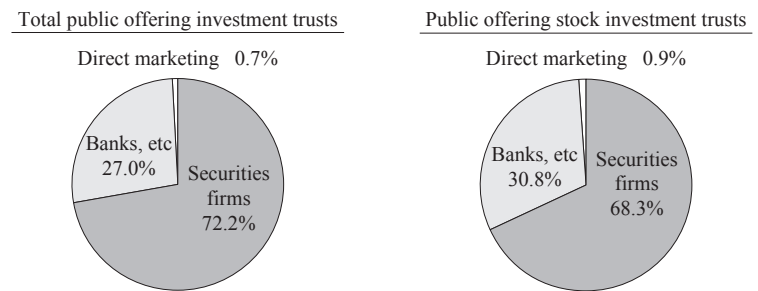


Chart VII-7. Changes in Composition of Total Net Assets of Publicly Offered Investment Trusts by Distribution Channel

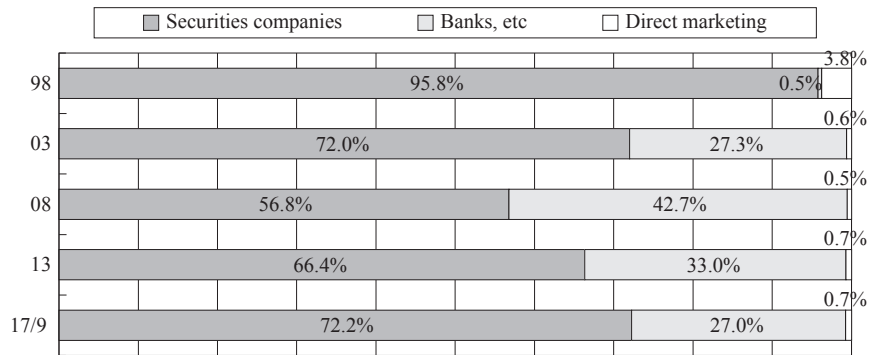
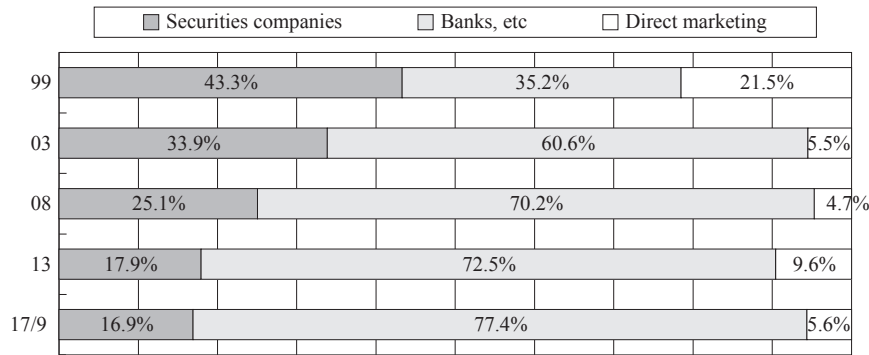


Chart VII-8. Changes in Breakdown of Total Net Assets of Overall Private Placement Trusts by Distribution Channel



Source: All the above are based on statistics of the Investment Trusts Association, Japan.

The sales commission for investment trusts, which had been determined by the funds, was liberalized in Japan as a result of amendments to the business rules of the Investment Trusts Association, Japan, in 1998. At present, different companies can charge different commissions even for the same fund. There have also been reductions in commissions and a diversification of commission systems.

6. Investment Management of Investment Trusts

Investment trusts invest mainly in “specified assets” defined by the Order for Enforcement of the Act on Investment Trusts and Investment Corporations. (As of September 2017, the specified assets consist of 12 types of assets, including securities, real estate, and rights associated with derivatives trading.) Funds investing mainly in securities are called securities investment trusts.

Chart VII-9 shows the distribution of assets under the management of publicly offered securities investment trusts as of September 2017. Reflecting an improvement in stock market conditions, the ratio of stocks is high while the ratio of bonds is declining due to low interest rates. Moreover, blue-chip stocks are being given preference in the selection of the domestic stocks included in the funds, such as electric, information and communications stocks.

In operating business activities, investment trust management companies, which invest their assets according to the investment policies described in the prospectus of funds, are subject to the Special Provisions Concerning the Investment Management Business of the Financial Instruments and Exchange Act. They assume the duty of sincerity to customers and the duty of loyalty and the duty of due care of a prudent management to the beneficiaries; they also are prohibited from undertaking these activities: (1) transactions between managing assets and the investment trust management company or its directors/executive officers; (2) transactions among funds under management (excluding certain portions); (3) transactions for the purpose of its own benefit or the benefit of other parties by taking advantage of the changes in price of specific financial instruments resulting from such transactions; (4) transactions whose terms are different from those of ordinary transactions and that affect adversely the benefits of beneficiaries; (5) transactions of securities and other transactions for its own account by using information obtained through transactions for investment management; and (6) cases in which an investment trust management company or some third party provides beneficiaries or a third party with compensation to offset a loss or increase profit. As firewalls to promote profits of other businesses or of the parent company, subsidiaries, etc., executing unnecessary transactions in light of the investment management policy, the amount of assets managed and market condi-

Chart VII-9. Distribution of Assets of Investment Trusts in Japan (as of September 30, 2017, total publicly offered securities investment trusts)

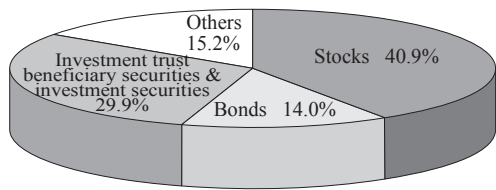
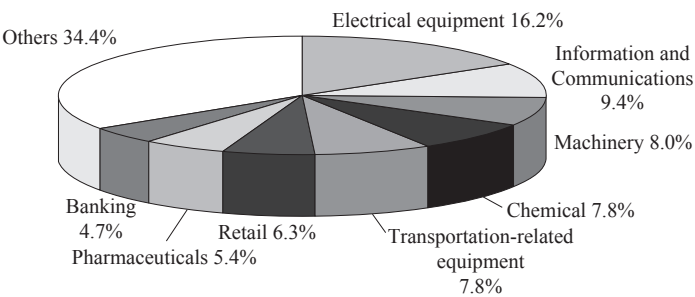


Chart VII-10. Breakdown by Industry Group of Domestic Stocks Held by Investment Trusts (publicly offered stock investment trusts as of the end of September 2017)



Source: All of the charts on this page are based on data from the Investment Trust Association, Japan.

tions, was prohibited. Additionally, the Investment Trust Act imposes a restriction on investment trust management companies prohibiting them from giving instructions to acquire stocks of the same issuing company when the number of stocks held by all investment trusts managed by the given investment trusts management company exceeds 50% of the total number of outstanding stocks of that same issuing company. The Investment Trusts Association, Japan, has self-regulatory rules concerning investment instruments and investment methods in addition to those concerning credit risk regulations.

The Investment Trust Act stipulates that an investment trust management company exercises the rights of shareholders, including voting rights, on portfolio stocks. Investment trust management companies disclose their basic policies on and the results of the exercise of voting rights on their websites. Additionally, in accordance with Japan’s Stewardship Code formulated in 2014, activities to promote engagement by listed companies are also under way.

Table VII-2. Exercise of Voting Rights for Domestic Stocks at General Shareholders Meetings by Investment Trust Management Companies (2016)
— Voting on Items Proposed by Companies, Total for 67 Companies that Invest in Domestic Stocks —

Name of proposal	For (A)	Against (B)	Abstain (C)	Total of Against and Abstain (D) (B)+(C)	Total number of proposals (E) (A)+(B)+(C)	Percentage of votes against, etc. (D)/(E)
(1) Appropriation of surplus	30,520	1,160	9	1,169	31,689	4%
(2) Election of Directors*1	61,715	14,422	22	14,444	76,159	19%
(3) Election of Auditors*1	27,378	8,903	12	8,915	36,293	25%
(4) Partial amendment to the Articles of Incorporation	14,802	783	3	786	15,588	5%
(5) Payment of retirement benefits	2,110	1,973	5	1,978	4,088	48%
(6) Revision of amounts of remuneration for corporate officers	18,154	729	9	738	18,892	4%
(7) Issuance of subscription rights/warrants	3,535	578	0	578	4,113	14%
(8) Election of accounting auditor	767	5	0	5	772	1%
(9) Reconstruction related*2	779	35	0	35	814	4%
(10) Other proposals by the company*3	6,282	2,763	5	2,768	9,050	31%
Total	166,042	31,351	65	31,416	197,458	16%

*1 If for a proposal on election of multiple candidates, a vote against one candidate is made, the vote for the proposal is recognized as “against” for data compilation purposes.

*2 Merger, business transfer/acquisition, share exchange, share transfer, company split

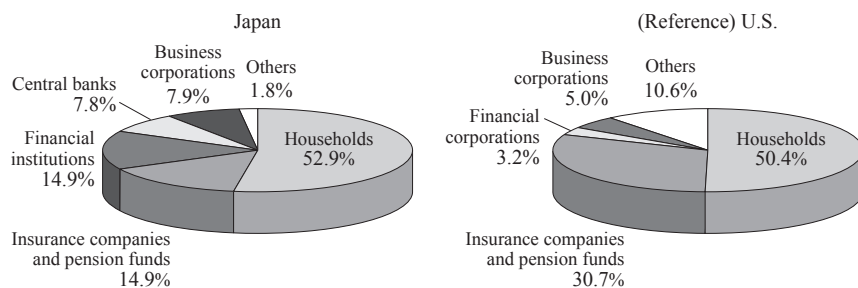
*3 Proposals other than (1) to (9) above (takeover defense measures, capital increase by third-party allotment, decrease in statutory reserve, purchase of treasury shares, capital decrease, share consolidation, etc.)

Source: The Investment Trusts Association, Japan “Results of Questionnaire Survey on Exercise of Voting Rights by Investment Trust Management Companies” 2016

7. Customer Base of Investment Trusts

Chart VII-11 shows the breakdown of beneficiaries of investment trusts (in terms of value). Over 50% of investment trust assets are held by households, with the remaining nearly 40% accounted for by insurance companies, pension funds, business firms, and financial institutions. Japanese households hold a high share of investment trusts, much like U.S. households, but privately held pensions are thought to account for a lower share compared with the United States. Meanwhile, the holding ratio of the BOJ increased as a result of active ETF purchases made by the central bank.

Chart VII-11. Breakdown of Holders of Investment Trusts (as of the end of 2016)



Source: Bank of Japan, "Flow of Funds Accounts". Source: FRB, *Flow of Funds Accounts*.

Table VII-3. Profiles of Individual Investors Holding Investment Trusts (2015)

Investment trust holding ratio by age			Investment trust holding ratio by annual income	
	Male	Female		
Aged 20 to 24	0.9%	1.1%	Less than ¥1 million	5.6%
Aged 25 to 29	1.4%	3.8%	¥1 million or above, less than ¥2 million	6.9%
Aged 30 to 34	4.6%	1.0%	¥2 million or above, less than ¥3 million	10.7%
Aged 35 to 39	7.3%	4.3%	¥3 million or above, less than ¥4 million	10.0%
Aged 40 to 44	7.6%	4.3%	¥4 million or above, less than ¥5 million	10.3%
Aged 45 to 49	6.3%	7.6%	¥5 million or above, less than ¥7 million	10.9%
Aged 50 to 54	10.7%	8.2%	¥7 million or above, less than ¥10 million	17.6%
Aged 55 to 59	11.5%	8.5%	¥10 million or above	31.4%
Aged 60 to 64	11.8%	12.2%		
Aged 65 to 69	14.6%	12.6%		
Aged 70 to 74	18.4%	11.4%		
Aged 75 to 79	11.8%	9.6%		
Aged 80 to 84	17.2%	9.7%		
Aged 85 to 89	15.4%	4.2%		
Aged 90 or above	16.7%	0.0%		
Overall average: 8.7%				

Source: JSDA "Nationwide Survey (on individuals) concerning Securities Investment Trusts)" FY2015 issue

Though households are a core holder of investment trusts, the penetration of investment trusts into household financial assets is low. A 2015 survey that was conducted by the Japan Securities Dealers Association indicates that holders of investment trusts include only 8.7% of the adult population. That ratio is extremely down from the level of more than 16% in 1988 during the bubble economy. The penetration shows a sign of recovery after reaching the

Table VII-4. Purpose of Purchasing Investment Trusts by Individual Investors

Japan		(Reference) U.S.A.	
Living costs after retirement	40.1%	Funds after retirement	72%
No particular purpose but to increase funds	27.8%	To prepare for emergencies	8%
Diversification of risks associated with assets	24.1%	Supplementary to current revenue	7%
Learning about economics	12.3%	Education funds	5%
Education funds for children or grandchildren	9.1%	Reduction of taxable income	4%
Leisure funds	6.3%	Funds to purchase house or other large item	3%
Housing funds	3.4%	Others	1%

Source: The Investment Trusts Association, Japan “Questionnaire Survey on Investment Trusts” 2015; multiple answers allowed; indication of top items only

U.S.A.: ICI (2015), Profile of Mutual Fund Shareholders; response to “primary financial goal”

bottom of 6.1% in 2003. By age group, the holding rate of investment trusts is 10% for people aged 60 or more, while it is only 0 to 3% for people in their 20s. It is noticeable that the holding rate is extremely low in young people. This indicates an environment in Japan in which financial assets held by individuals are concentrated among the elderly. In the U.S., though the groups of those aged 45 to 54 and 55 to 64 comprise the top groups, the groups of those aged 35 to 44 and those under 35 stood at 46% and 35%, respectively, demonstrating an environment in which the average penetration of investment trusts among households is above 40% (as of 2016). It is desired also in Japan that enhancing the individual-type defined-contribution pension plan, including NISA, Junior NISA, Dollar-Cost Averaging NISA and iDeCo, will drive an increase in the holding of investment trusts among the younger age groups.

In 2016, the amount subscribed by individuals averaged ¥4.04 million for unit-type publicly offered stock investment trusts for which statistics are available, while in terms of the numbers of subscribers, the category of ¥0.5 million – ¥1 million accounted for 25% and that of ¥1 million – ¥3 million accounted for 35% of the total subscribers.

Many investors previously answered that they had no specific investment purpose as their reason for buying investment trusts (Japanese people traditionally save money for unexpected purposes, i.e., “for a rainy day”). Recently, however, more and more individuals are buying investment trusts for “post-retirement living expenses.” In the U.S., the majority of individuals buy investment trusts for their retirement. In many cases, Americans continuously purchase the trusts via accounts for defined contribution pension plans, including the 401k. (This results in a higher holding rate among the young and middle-aged groups.) In contrast, many buyers do not have any specific purpose in Japan. In many cases, they do not make monthly payments into

investment trusts; rather, they invest a good sum of money at one time, and this is estimated to be largely dependent on the movement of the securities markets.

8. Disclosure of Investment Trusts

Until 1997, disclosure of investment trusts was covered not by the Securities and Exchange Act but by the framework defined in the Securities Investment Trust Act (now the Act on Investment Trusts and Investment Corporations). Following the deregulation of the establishment of funds, in which the filing system replaced the approval system, as a result of the enforcement of the Act on Revision, etc. of Related Acts for the Financial System Reform in 1998, the Securities and Exchange Act (now the Financial Instruments and Exchange Act) was applied to investment trusts the same as to stocks, etc. Therefore, publicly offered investment trusts are now subject to both the Investment Trust Act and the Financial Instruments and Exchange Act in terms of disclosure. Details of disclosure are summarized as follows.

Issuance Disclosure

As issuance disclosure, the Financial Instruments and Exchange Act requires investment trust management companies to file the “securities registration statement” with the regulatory authorities (for public inspection) and to deliver the “prospectus” to individual investors at the time of subscription. Given the unique characteristics of the way in which investment trusts are sold (while offering for subscription of stocks is made only at initial public offering and capital increases, and at other times, investors purchase issued stocks on the secondary market, investment trusts are continuously offered after establishment of funds by initial subscription), the prospectuses were split into two volumes to “provide investors with information in an easy-to-understand manner” in 2004. That is, the two volumes consist of a “summary prospectus,” which distributing companies are required to deliver in advance to all investors entering into contracts, and a “detailed prospectus,” which distributing companies deliver to investors when requested.

As issuance disclosure, the Investment Trust Act requires investment trust management companies to “notify the details of the basic terms and conditions” to the regulatory authorities and to “deliver documents describing the details of the basic terms and conditions” to the investors. Descriptions in the prospectus are substituted for the latter.

Periodic Disclosure

In terms of disclosure after the establishment of investment trust funds, the

Table VII-5. Publicly Offered Securities Investment Trusts Disclosure System of Japan

	Statutory disclosure				Voluntary disclosure
	Disclosure for supervisory authorities and for public inspection		Individual disclosure for investors		Public disclosure for investors
	FIEA	Act on Investment Trusts and Investment Corporations	FIEA	Act on Investment Trusts and Investment Corporations	The Investment Trusts Association, Japan Rules, etc.
Issuance Disclosure (Disclosure at offering)	Securities Registration Statement Amendment of Securities Registration Statement	Registration on the contents of the agreement	Prospectus (Summary prospectus) (Detailed prospectus)	Document summarizing the contents of the agreement (may be indicated in the prospectus)	Define the Guidelines on Preparation of Prospectus
Periodic Disclosure (disclosure while under management)	Annual Securities Report Semi-annual Securities Report Extraordinary Report	Financial report (investment report)		Financial report (investment report) (Summary financial report) (full-version financial report)	Monthly disclosure of MMF, MRF and timely disclosure on the website of each investment management company

Source: Author of the chapter

Financial Instruments and Exchange Act requires investment trust management companies to file their “securities report” to the regulatory authorities after the end of each accounting period (for public inspection). (Semi-annual securities reports are also filed when funds settle accounts once a year.)

As for periodic disclosure, the Investment Trust Act requires investment trust management companies to deliver their “financial report” to individual investors. In 2014, it was decided that the financial report would be made available in two phases based on an approach similar to having two volumes of prospectuses as described above: a summary financial report issued to all beneficiaries and a financial report (full version) publicized on the website of the management company and issued to beneficiaries upon request.

In addition, the Investment Trusts Association, Japan, has established “timely disclosure” provisions as self-regulatory rules that should be posted on the website of each investment trust management company, and this disclosure is performed at least monthly for each fund.

Table VII-6. Major Items in Summary Prospectus (Explanatory Document) of Publicly Offered Investment Trust

Items recorded	Contents recorded
(Items recorded on the front page, etc.) (1) Name of fund and product category (2) Information on investment trust management company, etc.	Name of the fund indicated on the securities registration statement and product category in the Guidelines Concerning Product Categories set forth by the Investment Trusts Association, Japan. Name of investment trust management company, date of establishment, paid-in capital, total net asset value of investment trusts managed, website address, telephone number, name of trustee, etc.
(Items recorded in the main text) (1) Fund objective and characteristics (2) Investment risks (3) Investment performance (4) Procedure, commission, etc. (5) Additional information	Fund characteristics and investment focus based on the basic investment policy, investment attitude, etc. provided in the agreement; Matters reflecting the fund characteristics, e.g., fund structure, investment method, investment process, investment restrictions, and distribution policy; If investment management is outsourced, the name of the investment manager and the content of outsourcing Factors underlying fluctuations in standard price, risk management system, comparison with other assets (i) Transition of standard prices and net assets in the last decade—standard prices illustrated using a line graph; net assets illustrated using a bar or area graph (ii) Transition of distributions in the last decade (iii) Status of core assets—top 10 portfolio issues, ratio by industry, ratio by asset type, etc. (iv) Transition of annual earnings ratio in the last decade—illustrated using a bar graph. For funds with benchmarks, also indicate the percentage changes of benchmarks (i) Subscription memo (purchase price, application procedure, trust period, taxes, etc.) (ii) Fund costs (commission at purchase, partial redemption charge, investment management cost (trust fees) and allocation thereof, other expenses, taxes If there is a need to provide explanations on fund characteristics and risks in a greater detail (e.g., for fund of funds, use of structured bonds and derivatives), the details

Source: Cabinet Office Order on Disclosure of Information on Regulated Securities and the JITA Rules on Preparation of Summary Prospectus (as of September 2017)

9. Services and Products Based on Investment Trusts

Cash Management Account

The account is to combine the securities trading accounts of securities companies and money reserve funds (MRFs), open-end bond investment trusts for the account, via auto transfer. Recently, the MRFs have been replaced with bank accounts in some cases. The account invests its remaining idle monies, including the interest on bonds, dividends on stocks, and proceeds from the sale of securities, in MRFs and also offers such services as payment on the acquisition of securities, cash advance on ATMs, and securities-backed loans. The accounts were established in October 1997 on the model of the CMA (Cash Management Account) funds developed in 1977 by Merrill Lynch in the U.S. The Investment Trusts Association, Japan, imposes rules on MRFs on investment management, including one stipulating that investments should be made to financial instruments with high credibility and with a short term up to maturity in light of liquidity and security.

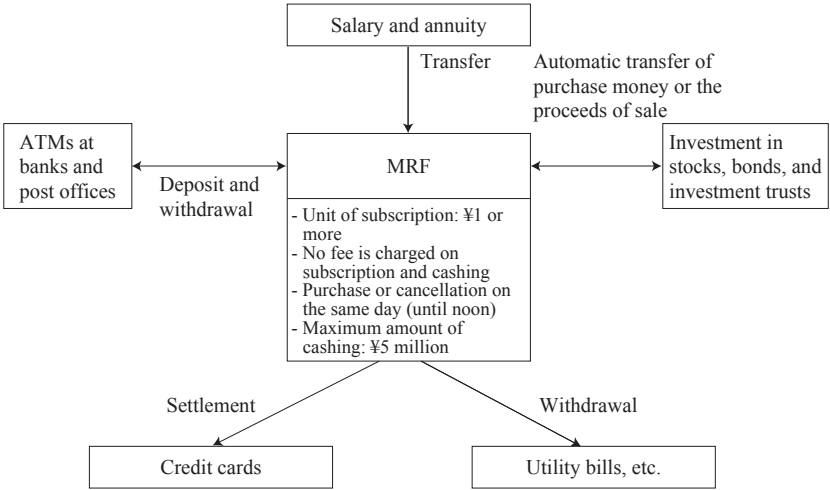
Wrap Account

A wrap account is a product that securities companies, etc. bundle and for which they offer a set of asset management services, including the determination and rebalancing of asset allocation and the selection of individual issues and management reports, only in exchange for annual fees to customers' balance of assets (no commission resulting from trading). Wrap accounts, which invest their assets in investment trusts only, were commercialized following liberalization of sales commissions for investment trusts in 1998 and after obtaining permission to engage in the discretionary investment management business by securities companies. Wrap accounts are also commercialized to offer asset management services with individual issues, such as stocks, as a result of the complete liberalization of brokerage commissions in October 1999.

Defined Contribution Pension Plans (e.g., Japanese 401k, iDeCo)

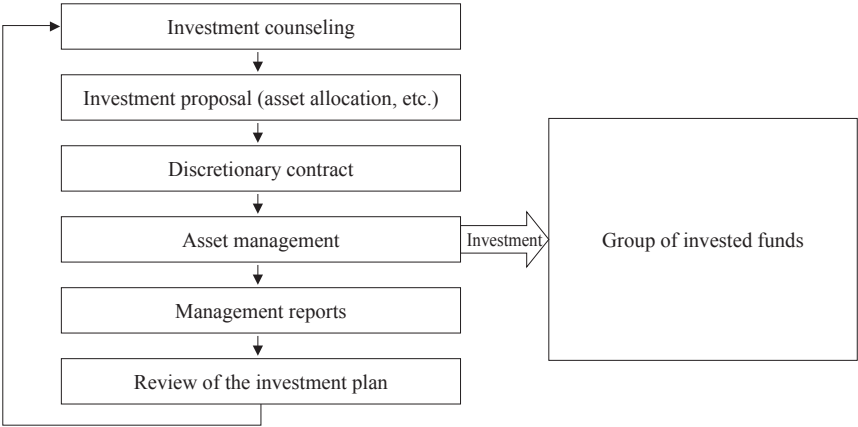
Partially backed by the increasing mobility of the employed and a deterioration in the financial positions of DB (defined benefit) corporate pensions, DC (defined contribution) pension plans offering high portability began to be offered in 2001. The participants in corporate DC plans invest their company contributions (contributions to the reserves by employees have been permitted since 2012), and participants in individual-type DC plans (referred to as "iDeCo") invest their own distributions in investment instruments, including investment trusts, stocks, bonds, and bank deposits, at their own responsibility. Their performances are reflected in future receivable pensions. Many in-

Chart VII-12. Outline of a Securities General Account



Source: Author of chapter.

Chart VII-13. Flow of Wrap Account Service (example)



Source: The above chart is based upon information on the web site of Nomura Securities Co., Ltd.

vestment trust companies offer low-cost funds exclusively for individual-type defined-contribution pension funds.

Variable Annuities

Variable annuities, which were launched in full scale in 1999, are products offered by insurance companies. Just as with the defined contribution pension plans, variable annuities also invest premiums from policyholders in investment trusts, and receivable pension amounts are determined by their performance. In addition to securities companies, banks have also begun selling these products.

10. Foreign Investment Trusts

The sale of foreign investment trusts established under foreign laws in foreign countries was liberalized in 1972. Initially, foreign investment trusts were subject to regulations stating that they should be invested mainly in foreign-currency-denominated assets and that a weighting of yen-denominated assets was limited to below 50% of the total assets, in consideration of the effect on domestic investment trusts. However, foreign private placement investment trusts were introduced into Japan, as foreign investment trusts were not subject to the Securities Investment Trust Act. At that time, private-placement investment trusts had yet to be recognized in Japan.

As a result of amendments to the Investment Trust Act in 1998, foreign investment trusts have become subject to the same regulations as Japanese investment trusts under the revised act. Namely, the amendments require foreign investment trust management companies to file the same notification as Japanese investment trusts at the sale of foreign investment trusts in Japan and to allow Japanese courts to issue an order to prohibit or stop the sale of foreign investment trusts if inappropriate investment management of foreign investment trusts impairs the profits of domestic investors and if there is an urgent necessity to prevent further losses to investors. It is also permitted to introduce yen-denominated funds into Japan, for which currently the same tax system as Japanese investment trusts is applied to foreign investment trusts. The disclosure system is common to Japanese and foreign investment trusts, including preparation and delivery of a prospectus and financial reports. The Japan Securities Dealers Association establishes “selection criteria of foreign investment trust beneficiary certificates” in the “rules concerning foreign securities transactions” to set the requirements for foreign funds available in Japan.

Table VII-7 shows the trend of total net assets of foreign investment trusts sold in Japan for the recent 20 years. The total net assets had been dependent

Table VII-7. Total Net Assets of Foreign Investment Trusts in Japan (¥100 million) and Their Ratio to Total (Public Offering) Investment Trusts

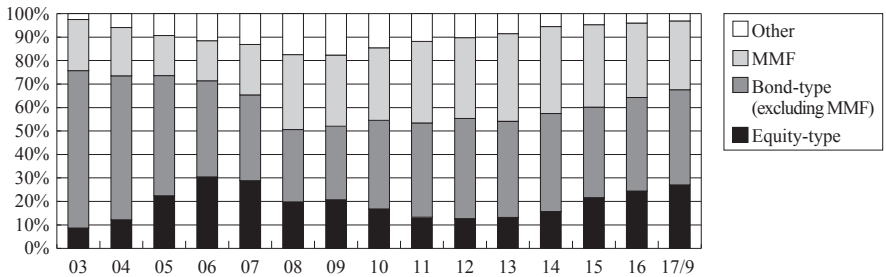
Year-end	Total net assets of foreign investment trusts (A)	Total net assets of domestic investment trusts (B)	Total (C)	(A)/(C)
1997	15,236	406,495	421,731	3.6%
98	29,352	327,393	356,745	8.2%
99	35,099	513,536	548,635	6.4%
2000	36,084	493,992	530,076	6.8%
01	41,426	452,807	494,233	8.4%
02	47,147	360,160	407,307	11.6%
03	54,427	374,356	428,783	12.7%
04	62,411	409,967	472,378	13.2%
05	79,670	553,476	633,146	12.6%
06	87,104	689,276	776,380	11.2%
07	82,427	797,606	880,033	9.4%
08	51,473	521,465	572,938	9.0%
09	59,306	614,551	673,857	8.8%
10	58,800	637,201	696,001	8.4%
11	52,358	573,274	625,632	8.4%
12	57,839	640,600	698,439	8.3%
13	61,290	815,200	876,490	7.0%
14	62,893	935,045	997,938	6.3%
15	54,248	977,562	1,031,810	5.3%
16	53,540	966,415	1,019,955	5.2%
17/9	58,375	1,052,320	1,110,695	5.3%

Note: The total net assets of domestic investment trusts are the total net assets of publicly offered investment trusts in Japan.

Source: Total net assets of foreign investment trusts and domestic investment trusts were taken from the Japan Securities Dealers Association and the Investment Trusts Association, Japan, respectively.

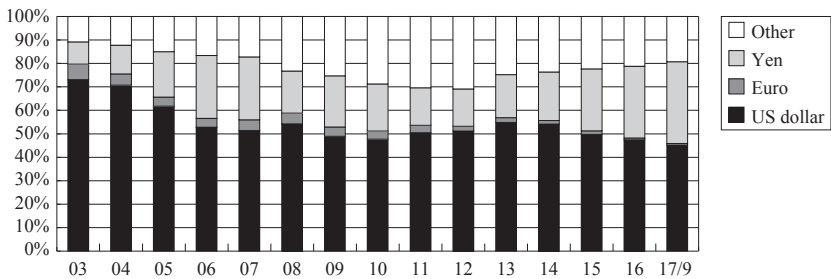
on the effects of exchange rates, etc. Sales of foreign investment trusts surged in Japan after 1997, reflecting a higher demand for high-yield foreign bonds and a tendency toward a weaker yen during the continued ultralow interest rate. The ratio of foreign investment trust assets to total investment trust assets, including domestic investment trusts, was above 13% in 2004. After that, the growth in sales of overseas registered investment trusts came to a halt due to the recovered popularity of domestic stock funds and an increase in monthly distribution funds registered in Japan. Stock investment trusts increased at one point as shown in Chart VII-14, and real estate and alternative funds grew also, after 2004 when stock prices recovered globally though broadly defined bond funds, including MMFs, continued to be mainstream. Looking at foreign investment trusts by country of establishment, Luxem-

Chart VII-14. Breakdown of Total Net Assets of Foreign Investment Trusts in Japan by Product Category



Source: Compiled by the author based on materials disclosed by the Japan Securities Dealers Association.

Chart VII-15. Breakdown of Total Net Assets of Foreign Investment Trusts in Japan by Presentation Currency



Source: Compiled by the author based on materials disclosed by the Japan Securities Dealers Association.

bourg investment trusts enjoyed an overwhelming share of the market in the past, but Cayman investment trusts have increased their share since around 2005. At the end of September 2017, Cayman, Luxembourg, and other investment trusts accounted for 52.4%, 37.5%, and 10.1% in terms of total net assets, respectively.

CHAPTER VIII

The Derivatives Market

1. Futures Trading

“Futures trading” refers to an agreement to buy or sell a specific amount of a commodity or financial instrument at a particular price on a stipulated future date. The history of futures trading is said to be as old as that of commodities trading. However, it is generally believed that the precursor of today’s fully developed futures market emerged in Japan as the account-balancing trading in rice (the rice market) conducted in Osaka in the Edo period (1603–1868). This was a method that made it possible for parties to consummate a transaction by organizing one-on-one negotiated transactions in such a way as to enable them to settle the difference without delivery of the underlying commodity or financial instrument and is considered the beginning of Japan’s futures trading. By inheriting this tradition, stock futures were traded by settling the difference in the form of margin transactions on the stock exchange in Japan in prewar years. After the war, margin transactions were prohibited by the General Headquarters (GHQ) of the Supreme Commander for the Allied Powers (SCAP) in Japan in order to curb speculative transactions, but some claim that margin trading with individual investors had been partly revived on the stock market.

In 1972, the Chicago Mercantile Exchange started trading in currency futures. The Chicago Board of Trade started trading in futures on fictitious bonds called benchmark issues in 1974, and the Kansas City Board of Trade started trading in stock index futures in 1982. And these types of futures trading spread to the stock exchanges of other countries around the world, including the introduction of trading in securities futures also in Japan. Long-term government bond futures trading that started on the TSE in 1985 was the first financial futures trading conducted in Japan. More products emerged in quick succession: the OSE’s “Osaka Stock Futures 50 (OSF50)” in 1987; the OSE’s Nikkei 225 futures contracts trading and the TSE’s TOPIX futures trading in 1988; and the Tokyo Financial Exchange Inc. (TFX)’s Japanese yen short-term interest rate futures, U.S. dollar short-term interest rate futures, and yen-dollar currency futures in 1989.

Table VIII-1. Years in Which Major Financial Futures of the World Were Listed

Year	Other countries	Japan
1972	Currency futures (mark-dollar and yen-dollar) (CME)	
1976	TB futures (CME)	
1977	Treasury bond futures (CBOT)	
1981	Eurodollar interest rate futures (CME)	
1982	S&P 500 futures (CME); T-note futures (CBOT); U.K. government bond futures and pound interest rate futures (LIFFE)	
1984	FTSE 100 futures (LIFFE)	
1985		Long-term government bond futures (TSE)
1986	French government bond futures (MATIF), Nikkei average futures (SIMEX)	
1987	Japanese government bond futures (LIFFE)	
1988	CAC40 futures; PIBOR (Paris interbank offered rate) futures (MATIF); BUND futures (LIFFE)	Nikkei 225 futures (OSE); TOPIX futures (TSE)
1989	Euroyen interest rate futures (SIMEX)	Euroyen short-term interest rate futures (TIFFE)
1990	Euromark interest rate futures (LIFFE); Nikkei average futures (CME); DAX futures and BUND futures (DTB)	
1991	Interbank interest rate futures (BM&F)	
1992	USD/RUB currency futures (MICEX)	
1996	Euroyen interest rate futures (LIFFE); NASDAQ 100 futures (CME); KOSPI 200 futures (KSE)	
1997	E-mini S&P 500 futures (CME)	
1998	EURIBOR futures (LIFFE), Euro STOXX 50 futures (EUREX)	
1999	E-mini NASDAQ 100 futures (CME)	
2000	CNX Nifty Index futures (NSE)	
2001	Single stock futures (LIFFE), E-mini Russell 2000 futures (CME)	
2002	Single stock futures (One Chicago)	
2004	VIX index futures (CFE)	
2005	RTS stock price index futures (RTS)	
2006		Exchange FOREX margin contracts (TFX)
2008	Russell 2000 futures (ICE)	Nikkei 225 mini futures (OSE)
2010	CSI 300 futures (CFFEX)	

Note: BM&F: Brazilian Mercantile and Futures Exchange (presently BM&F BOVESPA), CBOT: Chicago Board of Trade, CFE: CBOE Futures Exchange, CFFEX: China Financial Futures Exchange, CME: Chicago Mercantile Exchange, DTB: Deutsche Terminbörse (presently Eurex), ICE: ICE Futures U.S., KSE: Korea Stock Exchange (presently KRX), LIFFE: London International Futures and Options Exchange (presently ICE Futures Europe), MATIF: Marché à Terme International de France (presently Euronext Paris), MICEX: Moscow Interbank Currency Exchange (presently Moscow Exchange), NSE: National Stock Exchange of India, RTS: Russian Trading System (presently Moscow Exchange), SIMEX: Singapore International Monetary Exchange (presently SGX), TSE: Tokyo Stock Exchange; OSE: Osaka Securities Exchange (presently Osaka Exchange), TFX: Tokyo Financial Futures Exchange (presently Tokyo Financial Exchange).

Technically speaking, futures contracts are traded on the exchange. However, while a futures contract can be assigned to a third party, a margin has to be deposited to provide against nonperformance of the contract. A forward contract is a transaction made between parties. While it cannot be assigned to a third party, it does not require the deposit of a margin. Transactions in currency or short-term interest-rate futures are forward contracts often negotiated between a bank and its client, and they are called forward-exchange agreements (FXA) or forward-rate agreements (FRA). Along with swap trading, these two types of transactions played a leading role in boosting the derivatives markets around the world in the 1990s.

2. Bond Futures Trading

Trading in securities futures (Government National Mortgage Association [GNMA] certificates) started in 1974 in the United States. Trading in 10-year government bond futures was conducted on the Tokyo Stock Exchange in 1985—the year in which they were issued in massive amounts—and this was the first financial futures trading in Japan. In 1988, superlong-term (20-year) government bond futures (discontinued in 2002, but resumed in 2014) were listed on the Tokyo Stock Exchange, and trading in U.S. Treasury bond futures, which had the largest trading volume in the world, started on the Tokyo Stock Exchange in 1989. With the trading in medium-term (5-year) government note futures that started on the Tokyo Stock Exchange in 1996, Japan had finally developed a product mix comparable to that of other countries.

Bond futures are generally traded on the basis of a fictitious issue called a benchmark issue whose price is assumed to indicate the level of yield curve then prevailing. Therefore, the price of bond futures is formed in the belief that the prices of individual bonds are above the yield curve of the benchmark issue or above a yield curve that runs parallel to it. Because a seller can choose an issue just as in a regular settlement, the seller chooses the most reasonably priced issue at that point in time, but the price of the issue to be delivered is computed by multiplying the price of the benchmark issue by a conversion factor prescribed by the exchange.

One of the characteristics of the bond futures trading conducted in Japan is that issues are traded in units with a total par value of ¥100 million, about 10 times as large as that of other countries. (This compares with \$100,000 in the case of treasury bond futures traded on the Chicago Board of Trade, or 100,000 Eurodollars in the case of BUND futures traded on the EUREX.) This is due to the fact that in cash bond transactions, bonds whose value falls short of ¥100 million are treated as a fraction of a trading unit. As bond futures trading is usually compared with that of other countries in terms of the

Table VIII-2. Trading Mechanism of Bond Futures

	Medium-term JGB futures	Long-term JGB futures	Superlong-term JGB futures
Trading object	Medium-term JGB Standardized 3%, 5-year residual	Long-term JGB Standardized 6%, 10-year residual	Superlong-term JGB Standardized 3%, 20-year residual
Delivery object	Interest-bearing 5-yr. govt. notes with a remaining life of 4 yrs. to 5 yrs. and 3 mos.	Interest-bearing 10-yr. govt. notes with a remaining life of 7 to 11 yrs.	Interest-bearing 20-yr. govt. bonds with a remaining life of 19 yrs. and 3 mos. to 20 yrs.
Contract month	3 contract months from March, June, September, December	3 contract months from March, June, September, December	3 contract months from March, June, September, December
Delivery date	20th of March, June, September, December	20th of March, June, September, December	20th of March, June, September, December
Final trading day	7 business days prior to the delivery date	7 business days prior to the delivery date	7 business days prior to the delivery date
Trading hours	8:45-11:02, 12:30-15:02, 15:30-5:30 the following day	8:45-11:02, 12:30-15:02, 15:30-5:30 the following day	8:45-11:02, 12:30-15:02, 15:30-5:30 the following day
Trading unit	¥100 million in par value	¥100 million in par value	¥100 million in par value
Price asked	¥0.01 per par value of ¥100	¥0.01 per par value of ¥100	¥0.01 per par value of ¥100
Daily price limit	Standard: Base price \pm ¥2.00 Maximum: Base price \pm ¥3.00	Standard: Base price \pm ¥2.00 Maximum: Base price \pm ¥3.00	Standard: Base price \pm ¥4.00 Maximum: Base price \pm ¥6.00
Circuit breaker mechanism	In a futures trading, if following a buy (sell) order for the central contract month placed (or contracted) at the upper (lower) price limit, there is no trade execution at a price outside the price range from the upper (lower price) limit to the immediately executable price range (for medium-term and long-term JGB futures, last traded price plus or minus 0.1 yen, for superlong-term JGB futures, last traded price plus or minus 0.3 yen) for one (1) minute, trading is suspended for 10 minutes.		

Table VIII-3. Transition in Bond Futures Trading

	Medium-term JGB futures		Long-term JGB futures		Superlong-term JGB futures	
	No. of deals	No. of contracts	No. of deals	No. of contracts	No. of deals	No. of contracts
2013	0	0	9,132,122	98,944	—	—
2014	0	0	8,791,553	96,722	5,041	107
2015	0	0	8,677,576	95,509	2,978	127
2016	0	0	7,383,298	80,838	843	19
2017	0	0	8,190,265	96,251	303	1

Source: Website of the Japan Exchange Group (JPX).

number of contracts, futures traded in Japan tend to be underestimated.

It is said that another characteristic of the bond futures market of Japan is that it is concentrated in trading in long-term government bond futures. This is likely to be related to the fact that the maturities of government bonds, though to a lesser extent than before, tend to be primarily in 10-year issues. Yet this stands in contrast with the U.S. and Germany where medium-term bond futures trading maintains liquidity.

Since the mid-1990s, however, the concentration of cash government bond trading on the benchmark issue, which was a phenomenon peculiar to Japan, has eased. Since the end of March 1999, the practice of designating a government bond as a benchmark issue has been discontinued, with 10-year government bond futures assuming the role played by benchmark issues. Among new products, contract for difference (CFD) futures on mini-long-term government bonds, which are one-tenth the amount of normal bonds, were listed on the Tokyo Stock Exchange from the end of March 2009, but trading accounts for less than 1% of long-term government bond futures.

3. Stock Index Futures Trading

The first stock index futures contract was listed in the United States in 1982. In Japan, the Osaka Securities Exchange started trading *kabusaki* 50, a futures contract for a basket of 50 stocks, in 1987. That product was followed in 1988 by the listing of Nikkei 225 futures on the Osaka Securities Exchange and TOPIX futures on the Tokyo Stock Exchange. Nikkei 300 futures were listed on the Osaka Securities Exchange in 1994. In 1998, High-Tech 40, Financial 25, and Consumer 40 stock index futures started to be traded on the Osaka Securities Exchange and sector index futures contracts for three industries, electric appliances, transportation equipment, and banks, were listed on the Tokyo Stock Exchange. The Tokyo Stock Exchange launched S&P/TOPIX 150 stock index futures in 2001, while three futures contracts based, respectively, on the MSCI Japan, the FTSE Japan, and the Dow-Jones Industrial Average indices were listed on the Osaka Securities Exchange (OSE) in 2002. RN (Russell Nomura) Prime Index futures commenced trading on the OSE in 2005, followed by Nikkei 225 mini-futures on the OSE in 2006, and the TOPIX mini, TOPIX Core30, and TSE REIT index futures on the TSE in 2008. In 2010, the OSE introduced the Nikkei Stock Average Dividend Point Index and the TSE introduced TOPIX and TOPIX Core30 dividend indexes, while the Tokyo Financial Exchange launched Nikkei 225 equity margin contracts. In 2012, the OSE began trading Nikkei Stock Average Volatility Index futures and NY Dow Jones Industrial Average futures. In 2014, CNX Nifty futures and JPX Nikkei Index 400 futures, and in 2016,

Table VIII-4. Trading Mechanism of Stock Index Futures

	Nikkei 225 mini futures	Nikkei 225 futures	TOPIX futures
Trading object	Nikkei stock average	Nikkei stock average	TOPIX
Contract month	Jun & Dec: Nearest 10 contract months Mar & Sept: Nearest 3 contract months Other months: Nearest 3 contract months	Jun & Dec: Nearest 10 contract months Mar & Sept: Nearest 3 contract months	5 months in the Mar, Jun, Sept & Dec quarterly cycle
Trading unit	Nikkei stock average $\times 100$	Nikkei stock average $\times 1,000$	TOPIX $\times \yen 10,000$
Price asked	Units of $\yen 5$ in Nikkei stock average	Units of $\yen 10$ in Nikkei stock average	Units of 0.5 points in TOPIX
Maturity	On the 2nd Friday of Mar, Jun, Sept, or Dec	On the 2nd Friday of Mar, Jun, Sept, or Dec	On the 2nd Friday of Mar, Jun, Sept, or Dec
Final trading day	One business day prior to the delivery date	One business day prior to the delivery date	One business day prior to the delivery date
Trading hours	8:45–15:15, 16:30–5:30 the following day	8:45–15:15, 16:30–5:30 the following day	8:45–15:15, 16:30–5:30 the following day
Daily price limit	Standard: Base price $\pm 8\%$ 2nd Expansion: Base price $\pm 12\%$ Maximum: Base price $\pm 16\%$	Standard: Base price $\pm 8\%$ 2nd Expansion: Base price $\pm 12\%$ Maximum: Base price $\pm 16\%$	Standard: Base price $\pm 8\%$ 2nd Expansion: Base price $\pm 12\%$ Maximum: Base price $\pm 16\%$
Circuit breaker mechanism	If, following a contract or buy (sell) order for the central contract month for a futures trading placed at the upper (lower) price limit, there is no trade execution for one (1) minute because of a fall (rise) of over 10% of the price limit range from the upper (lower) price limit, trading is suspended for 10 minutes.		

Table VIII-5. Transition in Stock Index Futures Trading

	Nikkei 225 mini futures		Nikkei 225 futures		TOPIX futures	
	No. of deals	No. of contracts	No. of deals	No. of contracts	No. of deals	No. of contracts
2013	233,860,478	673,736	30,907,691	420,037	22,714,121	594,299
2014	199,121,967	622,140	25,917,773	439,623	20,877,250	561,657
2015	247,159,359	370,373	27,678,234	416,962	22,303,956	602,235
2016	233,940,373	579,972	26,765,460	449,752	22,560,705	562,313
2017	219,518,050	683,633	23,054,495	413,373	24,392,610	665,746

Source: Website of the Japan Exchange Group (JPX).

TSE Mothers futures were listed on the Osaka Exchange. Prior to all these domestic listings for Nikkei 225 futures, the Singapore International Monetary Exchange (SIMEX, now SGX-DT) started trading SIMEX Nikkei 225 futures in 1986, followed in 1992 by dollar- and yen-denominated Nikkei 225 futures on the Chicago Mercantile Exchange (CME). In addition, SIMEX now also trades mini-futures.

Out of many futures contracts based on a variety of Japanese stock indexes or listed on different exchanges, the OSE Nikkei 225 futures are the most actively traded, while the TOPIX futures, Nikkei 225 mini-futures, and SGX Nikkei 225 futures contracts, are quite liquid, creating a rather unique situation in which there is more than one contract having good liquidity among the stock index futures.

Since June 1989, the last trading day falls, as is the case with the United States, one business day prior to maturity, and the final settlement price is decided on the basis of a special quotation (SQ) that is computed on the basis of the opening prices of component issues on the date of maturity. In addition to a three-stage daily price limit, the stock exchanges in Japan have instituted a system temporarily suspending trading (called the circuit breaker system) applicable not to the cash market but to stock index futures trading, which gives them the power to suspend trading when stock prices fluctuate violently. This system imposes restrictions on changes in stock prices in a manner different from the circuit breaker system of the United States, which suspends both cash and futures markets at the same time.

4. Financial Futures Trading

Currency futures trading started in the United States in 1972, and Eurodollar short-term interest rate contracts were the first interbank futures listed on a U.S. exchange, in 1982. In Japan, Euroyen futures, Eurodollar short-term interest rate futures (trading was suspended in 1998), and Japanese yen-U.S. dollar currency futures (contracts were delisted in 1992) were simultaneously listed on the Tokyo International Financial Futures Exchange in 1989. These contracts were followed by the TIFFE/TFX listings of dollar-yen futures in 1991; 1-year Euroyen futures in 1992 (trading was suspended in 1998); Euroyen LIBOR futures in 1999; 5-year and 10-year yen swap futures in 2003 (trading was suspended in 2007); and Exchange FOREX margin contracts (Click 365) on U.S. dollars, Euros, UK pounds, and Australian dollars in 2005. In 2009, the TFX listed overnight (O/N) uncollateralized call rate and general collateral (GC) spot-next (S/N) repo rate interest futures, and added margin contracts for Nikkei stock average, FTSE 100, and DAX indexes (Click 365) on the TIFFE (TIFFE was renamed the Tokyo Financial Ex-

Table VIII-6. Trading Mechanism of Financial Futures

	3-month Euroyen interest rate futures	USD-JPY exchange FOREX margin contracts	Nikkei 225 margin contracts
Trading unit	Principal ¥100 million	US\$10,000	Nikkei stock average × 100
Indicating method	100 minus rate of interest (% , 90/360 day basis)	Yen equivalent per U.S. dollar	Yen equivalent per stock price index
Price asked	0.005 (¥1,250)	0.01 (¥100)	¥1 (¥100)
Contract month	Mar, Jun, Sep, Dec, cycle (20 contract months traded at any one time)	No	No
Final trading day	Two business days prior to the third Wednesday of the contract month (transactions on the day of maturity must be executed by 11:00 a.m.)	No	No
Final settlement day	Business day following the final trading day	No	No
Settlement method	Settlement of differences (the final settlement price is equal to ¥100 less T1-BOR rounded off at the fourth decimal places)	Making up differences	Making up differences
Daily price limit	No	No	No
Trading hours	8:45–11:30, 12:30–15:30, 15:30–20:00	Monday 7:10 a.m. to 6:55 a.m. the following day Tuesday to Thursday 7:55 a.m. to 6:55 a.m. the following day	Friday 7:55 a.m. to 6:00 a.m. the following day 8:30 a.m.–6:00 a.m. the following day (5:00 a.m. during U.S. Daylight Savings Time)

Table VIII-7. Transition in Financial Futures Trading

	3-month Euroyen interest rate futures		USD-JPY exchange FOREX margin contracts		Nikkei 225 margin contracts	
	No. of deals	No. of contracts	No. of deals	No. of contracts	No. of deals	No. of contracts
2013	5,044,236	410,310	20,120,943	161,213	5,153,821	123,761
2014	2,708,318	243,219	12,550,958	461,345	5,065,037	139,036
2015	2,000,289	175,190	12,919,505	718,119	7,840,578	159,146
2016	2,506,430	159,565	14,992,697	544,263	5,203,500	172,940
2017	1,545,861	134,560	10,478,227	537,737	5,722,311	237,114

Source: Website of the Tokyo Financial Exchange.

change (TFX) in 2007) in 2010.

Financial futures trading in the United States began with futures and futures options on commodity tradings while European countries introduced financial futures exchanges for these products. In Japan, the market is split with bond and stock futures and futures options trading on the stock exchanges, while interbank interest rate and currency futures and options are traded on the TFX, a separate market established by some banks and securities companies.

On the TFX, trading has been concentrated from the start in yen short-term rate futures, with little trading in other futures. To increase the liquidity of these financial futures, the market-making system was introduced for dollar short-term rate futures and yen-dollar currency futures in 1990, dollar-yen currency futures in 1991, and options on yen short-term rate futures in 1992. However, their liquidity did not improve much.

Meanwhile, in 1996 TIFFE introduced a TIFFE-SPAN (Standard Portfolio Analysis of Risk) system on the basis of which the amount of margin commensurate with the risks involved is computed. Moreover, in an effort to stimulate financial futures trading, it linked the prices of its products to those of the London International Financial Futures and Options Exchange (LIFFE) and extended its trading hours in the same year. It made efforts to stimulate trading by introducing the night-trading system for dollar-yen currency futures in 1997. Since 1995, however, TIFFE/TFX's business, which had grown during the first half of the 1990s, has been decreasing on account of the extremely low interest rate climate. Meanwhile, trading of Click 365, which was listed with an eye to the expansion of foreign exchange margin transactions, and trading of Click Stock 365, which is linked with Nikkei average stock prices, have established a presence.

5. Options Trading

Options trading refers to an agreement to trade the right to buy or sell a specific amount of a commodity or a financial instrument at a fixed price (the exercise price) within a specified period in the future. The right to become the buyer is called a call option, and the right to become the seller is called a put option.

The history of options trading goes back to antiquity. According to Aristotle, the first known option trading was written by Thales (ca. 620–ca. 555 BC), a Greek philosopher, on the sale of an olive press. The Chicago Board Options Exchange (CBOE) established in 1973 is the first fully developed options trading market. This was a method that made it possible for parties to consummate a transaction by organizing one-on-one negotiated transactions

Table VIII-8. Years in Which Major Financial Options of the World Were Listed

Year	Other countries	Japan
1973	U.S. options on individual stocks (CBOE)	
1974	U.S. options on individual stocks (AMEX, PHLX, PCX)	
1978	U.K. options on individual stocks (LTOM)	
1982	Currency options (PHLX), T-bond futures options (CBOT)	
1983	S&P 100 options; S&P 500 options (CBOE); S&P 500 futures options (CME)	
1984	Currency futures options (CME), FTSE 100 options (LIFFE)	
1987	Pound interest rate futures options (LIFFE), options on French individual stocks (MONEP)	
1988	French government bond futures options (MATIF); CAC40 options (MONEP); BUND futures options (LIFFE)	
1989		Bond OTC options (OTC); Nikkei 225 options (OSE); Nikkei 225 options (OSE); TOPIX options (TSE)
1990	Options on individual German stocks (DTB); Euroyen interest rate futures options (SIMEX); Euromark interest rate futures options (LIFFE); DAX options and BUND futures options (DTB)	Long-term government bond futures options (TSE)
1991		Euroyen short-term rate futures options (TFX)
1992	Nikkei average futures options (SIMEX)	
1994	JGB futures options (SIMEX)	
1997	KOSPI 200 options (KSE)	Options on individual stocks (TSE, OSE)
1998	EURIBOR futures options (LIFFE), Euro STOXX 50 options (EUREX), TAIEX options (TAIFEX)	
2000	U.S. options on individual stocks (ISE)	
2001	Nifty options (NSE), SENSEX options (BSE)	
2006	VIX index options (CBOE)	

Note: AMEX: American Stock Exchange (presently NYSE MKT), BSE: Bombay Stock Exchange, CBOE: Chicago Board Options Exchange, CBOT: Chicago Board of Trade, CME: Chicago Mercantile Exchange, DTB: Deutsche Terminbörse (presently EUREX), ISE: International Securities Exchange, KSE: Korea Stock Exchange (presently KRX), LIFFE: London International Futures and Options Exchange (presently ICE Futures Europe), LTOM: London Traded Options Market (presently ICE Futures Europe), MATIF: Marché à Terme International de France (presently Euronext Paris), MONEP: Marché des Options Négociable de Paris (presently Euronext Paris), NSE: National Stock Exchange of India, PHLX: Philadelphia Stock Exchange (presently Nasdaq OMX PHLX), PCX: Pacific Exchange (presently NYSE Arca), SIMEX: Singapore International Monetary Exchange (presently SGX), TAIFEX: Taiwan Futures Exchange, TSE: Tokyo Stock Exchange, OSE: Osaka Securities Exchange (presently Osaka Exchange), TFX: Tokyo International Financial Futures Exchange (presently Tokyo Financial Exchange).

in such a way as to enable them to settle the difference without delivery of the underlying commodity or financial instrument, similar to a futures trading, and is considered to have been the groundbreaking event in the history of options trading.

The options trading started by the CBOE in 1973 spread to other financial instruments, such as currency options trading, bond options trading, and bond futures options trading, in 1982; stock index options trading, and stock index futures options trading in 1983; and to currency futures options trading in 1984. And it has since spread to major financial markets worldwide. In Japan, OTC bond options trading (trading in bonds with options) was introduced in April 1989. The Osaka Securities Exchange introduced Nikkei 225 options in June, the Tokyo Stock Exchange introduced TOPIX options in October, and the Nagoya Stock Exchange introduced Options 25 in October 1989 (discontinued in 1998). The Tokyo Stock Exchange introduced long-term government bond futures options in 1990, and the Tokyo International Financial Futures Exchange (TIFFE) introduced yen short-term rate futures options in 1991. In addition, the Osaka Securities Exchange introduced Nikkei 300 options in 1994, and both the Tokyo Stock Exchange and the Osaka Securities Exchange introduced options on individual stocks in 1997. In 1998, the Osaka Securities Exchange introduced three industry-specific stock index options (High-Tech 40, Financial 25, and Consumer 40).

Listed options are traded on exchanges. While they can be assigned to a third party, the seller is required to deposit a margin with the exchange to provide against defaults on the contract. OTC options trading is a one-on-one transaction, and it cannot be assigned to a third party, but the seller is not required to deposit a margin. Unlike stock options and stock index options, many of the currency or interest rate options are traded with banks or securities companies on the OTC market.

6. Bond Options Trading

Treasury bond (T-bond) options trading (on the Chicago Board Options Exchange) and T-note options trading (on the American Stock Exchange) conducted simultaneously in 1982 constituted the first trading in listed bond options. And T-bond futures options were traded on the Chicago Board of Trade for the first time in 1982. In Japan, the first bond options trading was conducted on the OTC market in the name of “trading in bonds with options” in April 1989. Trading in long-term government bond futures options started in 1990, and trading in medium-term government note futures options (discontinued in 2002) started in 2000, both on the TSE.

Unlike bond futures trading, which is conducted on the basis of a bench-

Table VIII-9. Trading Mechanism of Bond Options Trading

	OTC bond options	Long-term government bond futures options	Medium-term government bond futures options
Trading object	All debt securities other than convertible bonds and warrant bonds	Call options or put options on long-term government bond futures	Call options or put options on medium-term government bond futures
Contract months	Free	March, June, September, December cycle (nearest two contract months traded at any one time), other months (up to nearest two contract months)	March, June, September, December cycle (nearest two contract months traded at any one time), other months (up to nearest two contract months)
Final trading day	—	The last trading day of the month immediately preceding Mar, Jun, Sep, and Dec.	The last trading day of the month immediately preceding Mar, Jun, Sep, and Dec.
Delivery date	Within one year and 3 months from the date of contract	Business day following the trading day	Business day following the trading day
Trading unit	¥100 million in par value	One contract on long-term JGB futures	One contract on medium-term JGB futures
Price asked	—	¥0.01 per par value of ¥100	¥0.01 per par value of ¥100
Option exercise price	Free	21 prices at ¥0.5 intervals, additional prices set according to price movement in underlying futures	21 prices at ¥0.5 intervals, additional prices set according to price movement in underlying futures
Daily price limit	—	Standard: Base price \pm ¥2.10 Maximum: Base price \pm ¥3.00	Standard: Base price \pm ¥2.10 Maximum: Base price \pm ¥3.00
Circuit breaker mechanism	—	When circuit breaker mechanisms are in place for the underlying futures contracts	When circuit breaker mechanisms are in place for the underlying futures contracts
Method of exercising the right	Free	American option	American option

mark issue, OTC bond options are traded on the basis of individual issues, such as government bonds, corporate bonds, or foreign bonds. Because they are traded on the OTC market, bond options agreements cannot be assigned to a third party (most of the transactions are for government bonds). As with government bond futures trading, bond options are traded in units of ¥100 million in par value. Because their life (from the date of contract to the date of delivery) is restricted to a maximum period of one year and three months, and as they cannot be resold to a third party, contracts usually run a relatively long period—six months or one year.

By contrast, long-term government bond futures options are available in

Table VIII-10. Transition in Bond Options Trading

	OTC bond options		Long-term government bond futures options		Medium-term government note futures options	
	Trading value	Outstanding price	No. of deals	No. of contracts	No. of deals	No. of contracts
2013	1,872,963	36,001	1,692,752	13,415	—	—
2014	1,898,342	27,471	1,133,723	20,105	—	—
2015	1,092,287	17,090	1,142,738	10,664	—	—
2016	1,120,506	15,390	958,472	9,997	—	—
2017	1,644,695	12,226	861,714	20,995	—	—

Source: The websites of the Japan Exchange Group (JPX) and the Japan Securities Dealers Association (JSDA).

the form of listed American options (the option can be exercised any day during its life), and their trading mechanism is similar to that of long-term government bond futures. Whereas long-term government bond futures have only three contract months with a maximum period of nine months, long-term government bond futures options offer up to four contract months with a maximum period of six months. In addition, compared with OTC bond options, transactions in long-term government bond futures and long-term government bond futures options are concentrated in those with a short remaining life.

In Western countries where options trading has long been conducted, investors are quite familiar with the system. However, in Japan, where there is no custom of options trading, investors utilize options trading less often than futures trading. Particularly, the amount of long-term government bond futures options trading is far smaller than that of long-term government futures trading. This is because investors’ interest is concentrated in outright transactions that deal only in options, and covered transactions are not made in conjunction with underlying assets (namely, long-term government bond futures). On the other hand, in conducting OTC bond options trading, investors follow the strategy of combining underlying assets with covered call or target buying.

7. **Stock Index Options Trading**

Trading in listed options on individual stocks started in 1973 on the Chicago Board Options Exchange (CBOE). In 1983, the CBOE introduced S&P 100 options (the first stock index options). The Chicago Mercantile Exchange (CME) listed S&P 500 futures options (the first stock index futures options

Table VIII-11. Trading Mechanism of Stock Index Options

	Nikkei 225 options	TOPIX options
Trading object	Call options or put options on Nikkei stock average	Call options or put options on TOPIX
Contract months	Jun and Dec contracts are nearest 10 months, Mar and Sept contracts are nearest 3 months, other contract months are 6 months, nearest four weekly contracts	March, June, September, December cycle (nearest 5 contract months), other months (nearest 3 contract months)
Trading unit	Nikkei stock average \times 1,000	TOPIX \times ¥10,000
Price asked	¥50 or less: ¥1; over ¥50 up to ¥1,000: ¥5; over ¥1,000: ¥10	0.1 points for prices up to 20 points, 0.5 points for prices over 20 points
Maturity	On the 2nd Friday of the delivery month	On the 2nd Friday of the delivery month
Final trading day	One business day prior to the delivery date	One business day prior to the delivery date
Trading hours	9:00–15:15, 16:30–5:30 the following day	9:00–15:15, 16:30–5:30 the following day
Option exercise price	Initially, 16 strike prices at ¥250 intervals; 16 strike prices at ¥125 intervals for closest 3 contract months when less than 3 months remaining	Over-4 month contracts: \pm 6 prices at 50-point intervals (if 4 months, same as 4 months or less), contracts of 4 months or less: \pm 9 prices at 25-point intervals
Method of exercising the right	European option	European option
Daily price limit	Normal: 4, 6, 8 or 11% according to the base price 1 st Expansion: Base price + 3% 2 nd Expansion: 1 st Expansion + 3%	Normal: 4, 6, 8 or 11% according to the base price 1 st Expansion: Base price + 3% 2 nd Expansion: 1 st Expansion + 3%
Circuit breaker mechanism	Possible interruption in connection with the actuation of the circuit breaker mechanism for Nikkei 225 futures trading	Possible interruption in connection with the actuation of the circuit breaker mechanism for TOPIX futures trading

ever) and the New York Stock Exchange (NYSE) listed the New York Stock Exchange Composite Stock Index futures options in 1983. In Japan, a series of stock index options have been listed—the Nikkei 225 stock index options on the Osaka Securities Exchange in June 1989, Options 25 on the Nagoya Stock Exchange in September of the same year (discontinued in 1998), and the TOPIX options on the Tokyo Stock Exchange in 1989. In 1994, the Nikkei 300 stock index options were introduced on the Osaka Securities Exchange (discontinued in 2010). Three industry-specific stock index options (High-Tech 40, Financial 25, and Consumer 40, discontinued in 2002) were also introduced on the Osaka Securities Exchange in 1998, and S&P/TOPIX

Table VIII-12. Transition in Stock Index Options Trading

	Nikkei 225 options		TOPIX options	
	No. of deals	No. of contracts	No. of deals	No. of contracts
2013	57,269,727	3,212,114	386,231	40,406
2014	43,958,283	2,430,568	320,313	47,805
2015	37,806,896	1,778,198	329,529	19,145
2016	33,763,728	1,911,257	145,716	46,641
2017	32,594,768	2,083,846	259,384	76,958

Source: Website of the Japan Exchange Group (JPX).

150 options (discontinued in 2002) were listed on the Tokyo Stock Exchange in 2001. In 2015, the Osaka Exchange introduced weekly options for the Nikkei 225 options. Meanwhile, trading in the Nikkei average futures options started in 1992 on the Singapore International Monetary Exchange (SIMEX, or the present SGX-DT).

In Japan, listed stock index options (the Nikkei 225 options) are most actively traded on the Osaka Securities Exchange. Unlike stock index futures, other stock index options are virtually not traded in Japan.

A comparison of the trading mechanisms of the Nikkei 225 options, the TOPIX options, and the SGX's Nikkei average futures options shows that while domestically traded stock index options are based on cash stock options, the Nikkei average futures options traded on the SGX are based on futures options. Another difference in the trading mechanisms is that the Nikkei 225 options and SGX's Nikkei average futures options offer long-term options. Meanwhile, in computing the amount of margins, all exchanges have adopted the method of netting margins in accordance with risks called Standard Portfolio Analysis of Risk (SPAN) developed by the Chicago Mercantile Exchange, and there is no significant difference among them. Among market measures, when the circuit breaker mechanism is tripped in stock index futures trading, options trading is also halted.

8. Securities Options Trading

Options on individual stocks listed on the Chicago Board Options Exchange, which was established in 1973, were the first call options on individual stocks. In 1977, put options were also listed on the same exchange. While the options on individual stocks were first listed and then stock index options were listed in other countries, in Japan stock index options were introduced in 1989 first and equity options on 20 individual stocks were listed afterward

Table VIII-13. Trading Mechanism of Securities Options

	Marketable securities options (TSE)	Marketable securities options (OSE)
Trading object	Call options or put options on domestically listed marketable securities	Call options or put options on domestically listed marketable securities
Contract month	Nearest two contract months + nearest two months from March, June, September and December	Nearest two contract months + nearest two months from March, June, September and December
Delivery date	5th day from the exercise of the right	5th day from the exercise of the right
Maturity	On the 2nd Friday of the delivery month	On the 2nd Friday of the delivery month
Final trading day	One business day prior to the delivery date	One business day prior to the delivery date
Trading unit	The trading unit of the underlying stock	The trading unit of the underlying stock
Price asked	8 stages from ¥0.1 to ¥5,000 depending on the price of the underlying security	16 stages from ¥0.1 to ¥5,000 depending on the price of the underlying security
Option exercise price	5 prices at 16 stages from ¥25 to ¥5 million depending on the price of the underlying stock, with additional prices available afterwards based on market	5 prices at 16 stages from ¥25 to ¥5 million depending on the price of the underlying stock, with additional prices available afterwards based on market
Daily price limit	Movement above and below the base price (price limit of eligible securities + allowable range for asking price)	The value derived by taking the base price of the security for the option trade on the designated market as of the trade date and multiplying it by 25%
Position limit	Set for each eligible security	Set for each eligible security
Trading hours	9:00–11:35, 12:30–15:15	9:00–11:35, 12:30–15:15
Method of exercising the right	European option	European option

Table VIII-14. Transition in Securities Options Trading

	TSE Securities Options		OSE Securities Options	
	No. of deals	No. of contracts	No. of deals	No. of contracts
2013	1,129,358	136,525	23,723	957
2014	—	—	1,062,389	171,176
2015	—	—	834,886	69,594
2016	—	—	922,341	32,543
2017	—	—	915,787	78,082

Note: On March 24, 2014, the derivatives market on the Tokyo Stock Exchange was merged with the derivatives market on the Osaka Exchange, and individual securities options trading on the Osaka Exchange was integrated with the marketable securities options trading on the Tokyo Stock Exchange as of that date, and was renamed as securities options trading. Transactions on the TSE prior to the integration are included in the OSE's data for the year 2014.

Source: Website of the Japan Exchange Group (JPX).

on the Tokyo Stock Exchange and the Osaka Securities Exchange in 1997 (seven of them were listed on both exchanges). Since then, option trading has been extended to all listed securities along with a name change to “securities options.” On March 24, 2014, the derivatives market on the Tokyo Stock Exchange was merged with the derivatives market on the Osaka Exchange, and individual securities options trading on the Osaka Exchange was integrated with the marketable securities options trading on the Tokyo Stock Exchange as of that date.

Soon after the Chicago Board Options Exchange was established, the advisability of introducing securities options to Japan was considered. However, it is said that their introduction was postponed for more than 20 years for fear that they might compete with margin trading, a major source of income for small- to medium-sized securities companies.

The mechanism of trading in marketable securities options is basically identical to that of stock index options but differs from that of stock index options trading in that the securities certificate underlying an option must be delivered to the buyer and that the final settlement price is decided on the basis of the closing price of the underlying certificate.

Although it was thought that securities options might compete with margin trading, they were not as actively traded. This is because there is no tradition of trading in options in Japan, investors are not familiar with options trading, and, unlike their Western counterparts, few individual investors are interested in options trading. Options are traded in combination with their underlying assets. In Japan, capital gains earned from trading underlying equities and from securities options are subject to separate taxation. However, investors are not allowed to offset gains and losses between these two categories. This is believed to have discouraged individual investors from participating in securities options trading. In other countries, brokers and dealers are granted preferential treatment for their market-making in relatively illiquid securities options. In a similar move, the Osaka Securities Exchange and Tokyo Stock Exchange introduced the Securities Options Market-Maker Program and TSE Securities Option Supporter system, respectively. These actions, however, have not resulted in any significant increase in the trading of these options in Japan.

9. OTC Derivatives Trading

The market on which derivatives trading achieved remarkable growth around the world in the 1990s was not the exchanges but the OTC market. Particularly, spurred by the financial liberalization, the interest rate swap trading that started in 1982 has spread not only to banking institutions, but also to busi-

Table VIII-15. OTC Trading in Securities Derivatives

Trading status (notional principal, ¥100 million)

Number of transactions	Total	Forward trading	Forward trading in OTC index, etc.	OTC options trading	OTC index swaps trading
FY2012	2,361,235 - 26.59%	297 0%	2,052,821 87%	298,054 13%	10,063 0%
FY2013	2,534,193 7.32%	20,649 1%	2,093,916 83%	408,759 16%	10,869 0%
FY2014	2,898,768 14.39%	88,204 3%	2,483,307 86%	296,602 10%	30,655 1%
FY2015	5,901,582 103.59%	4,153 0%	5,054,114 86%	280,341 5%	562,974 10%
FY2016	5,165,442 - 12.47%	1,874 0%	3,899,978 76%	237,830 5%	1,025,760 20%
Trading value	Total	Forward trading	Forward trading in OTC index, etc.	OTC options trading	OTC index swaps trading
FY2012	440,416 - 36.60%	1,265 0%	231,222 53%	178,515 41%	29,413 7%
FY2013	597,907 35.76%	56,295 9%	286,370 48%	219,541 37%	35,703 6%
FY2014	1,229,462 105.63%	178,068 14%	120,961 10%	614,448 50%	315,983 26%
FY2015	2,395,266 94.82%	96,127 4%	181,752 8%	1,616,245 67%	501,141 21%
FY2016	2,122,106 - 11.40%	85,368 4%	161,615 8%	1,525,389 72%	349,733 16%
Term-end balance	Total	Forward trading	Forward trading in OTC index, etc.	OTC options trading	OTC index swaps trading
FY2012	126,452 - 28.39%	345 0%	2,609 2%	86,233 68%	37,264 29%
FY2013	135,679 7.30%	6,295 5%	3,196 2%	76,424 56%	49,765 37%
FY2014	386,987 185.22%	7,717 2%	3,752 1%	163,205 42%	212,313 55%
FY2015	450,669 16.46%	10,620 2%	6,112 1%	209,056 46%	224,879 50%
FY2016	525,234 16.55%	13,689 3%	13,643 3%	326,160 62%	171,742 33%

Brokerage status (notional principal, ¥100 million)

Number of transactions	Total	Forward trading	Forward trading in OTC index, etc.	OTC options trading	OTC index swaps trading
FY2012	33,077 - 45.3%	277 1%	4,527 14%	22,168 67%	6,105 18%
FY2013	48,063 45.3%	20,579 43%	4,894 10%	16,102 34%	6,488 13%
FY2014	174,599 263.3%	86,969 50%	2,326 1%	27,123 16%	58,181 33%
FY2015	747,952 328.4%	2,892 0%	1,335 0%	26,102 3%	717,623 96%
FY2016	1,478,066 97.6%	1,081 0%	1,700 0%	18,814 1%	1,456,471 99%
Trading value	Total	Forward trading	Forward trading in OTC index, etc.	OTC options trading	OTC index swaps trading
FY2012	1,180,965 - 7.2%	1,592 0%	345,161 29%	759,661 64%	74,551 6%
FY2013	1,313,649 11.2%	56,197 4%	429,518 33%	727,941 55%	99,993 8%
FY2014	1,341,991 2.2%	143,579 11%	366,430 27%	743,337 55%	88,643 7%
FY2015	766,471 - 42.9%	22,312 3%	127,158 17%	437,802 57%	179,200 23%
FY2016	652,812 - 14.8%	73,469 11%	120,653 18%	205,564 31%	253,125 39%

Note: Figures next to annual total amounts represent percentage changes from the previous fiscal year. Percentages in parentheses elsewhere represent the ratio to the total for the year under the respective transaction types.

Source: Compiled based on the data available on the JSDA website.

ness corporations and has come to play the leading role on the derivatives market. As statistics on derivatives trading conducted on the exchanges have been well kept, it was easy to follow changes occurring in their trading, but because there was no organization that kept track of the derivatives trading conducted on the OTC market, it was extremely difficult to find out how it was doing. To remedy the situation, the Bank for International Settlements (BIS) decided to investigate, beginning in 1995, the derivatives markets along with—and on the occasion of—the triennial investigation of the foreign exchange markets to grasp the state of trading in derivatives on the OTC market worldwide.

According to a survey of the Japanese OTC derivatives market, including FX spot transactions, conducted in April 2016, the daily average notional value of OTC derivatives traded in Japan was \$454.9 billion, representing an increase of 22% from the figure in the previous survey in April 2013 (the results compare against a daily global total of \$7.744 trillion and an increase of 1%). By contract type, FX swaps were \$205.6 billion (up 21% from the 2013 survey); FX forwards were \$62.7 billion (up 78%); interest rate swaps were \$47.4 billion (down 15%); currency options were \$14.9 billion (up 132%); interest rate options were \$7.7 billion (down 10%); currency swaps were \$5.8 billion (down 9%); and forward-rate agreements (FRA) were \$0.8 billion (down 69%). The total notional value of the outstanding OTC derivatives contracts of financial institutions in Japan as of June 2016 stood at \$59.3 trillion, up 19% from June 2013, relative to the total of \$544 trillion and a 22% decrease worldwide. The breakdown of the total by contract type was 69.9% in interest rate swaps (compared with 71.5% in the 2013 survey); 6.5% in interest rate options (vs. 8.3% previously); 6.9% in foreign exchange forwards and swaps (vs. 6.3%); 9.2% in FRAs (vs. 4.9%); 4.4% in currency swaps (vs. 3.9%); and 1.8% in currency options (vs. 3.2%). By underlying instrument, equity increased 79%, and foreign exchange and interest rate derivatives contracts also increased 21% and 20%, respectively. Meanwhile, credit and commodity derivative contracts decreased 52% and 65%, respectively.

At the G20 Pittsburgh Summit in 2009, it was agreed that all OTC derivatives contracts standardized by the end of 2012 should be settled through central clearing organizations. In Japan, Japan Securities Clearing Corporation (JSCC), which belongs to the Japan Exchange Group (JPX), began clearing and settlement of CDS in July 2011, followed by clearing of interest rate swaps starting in October 2012. JSCC settles ¥70 to ¥90 trillion worth of yen-denominated interest rate swaps, which account for 90% of all interest rate swaps, on a monthly basis.

10. Credit Derivatives Trading

“Credit derivatives trading” refers to trading in credit risks involved in loans and corporate bonds in the form of swaps and options. While conventional derivatives trading bought or sold market risks, credit derivatives trading deals in credit risks. Credit risks trading may be characterized as trading in guarantees in that it not only deals in guarantees against default but also provides a variety of products that cover the risk of declining creditworthiness caused by a deterioration of business performance.

Credit derivatives are traded largely in three typical types: credit default swaps (CDS), total return swaps (TRS), and credit-linked notes (CLN). A CDS is a type of options trading that guarantees the credit risks involved in a loan, and when the borrower defaults on a loan underlying the CDS the damage caused by such default is guaranteed. CDS derives its name from the form in which the payment of a premium is swapped. Next, a TRS is a deal that swaps the total profit or loss (coupon and evaluated profit or loss) with the market rate, and it is used when the holder of a credit cannot sell it. And a CLN is a deal that links credit risks to a bond issued by the issuer of the underlying notes. Therefore, it may be said that a CLN is a CDS based on a bond instead of a guarantee. A CLN is redeemed in full on maturity unless the company designated in the contract defaults on its obligations, but when the company defaults the CLN is redeemed at a reduced value prior to maturity. While a CDS is concluded under the assumption that the guaranteeing company has an adequate capacity to guarantee, a CLN is guaranteed by the purchase of a bond. Therefore, a CLN has the advantage in that it can be concluded regardless of the credit standing of the investor.

According to the data published by the Bank of Japan, the total notional value of outstanding credit derivatives in Japan has been accelerating in growth since 2003, increasing by a factor of 83 from the end of December 2002 to the end of June 2011. Subsequently, however, the value declined almost constantly and was down to half or less of its peak by the end of June 2015. The notional value of outstanding credit derivatives has also been on a decrease in the U.S. after hitting a peak in 2008, but the degree of decline has not been as significant as that of Japan. During the period from 2008 when the nominal value of outstanding credit derivatives recorded its peak in the U.S., the outstanding balance of credit derivatives in Japan doubled over a period of three years from then. However, the outstanding balance halved from the end of June 2011 to the end of June 2015, reflecting erratic movements on the market.

Table VIII-16. Credit Derivatives Trading in Japan

(Outstanding balance of notional principal; US \$ million)																	
	OTC trading	Credit default swap			Total return swap			Credit spread product			Credit-linked notes			Other products			
		Total	Sell	Buy	Total	Sell	Buy	Total	Sell	Buy	Total	Issue	Purchase	Total	Sell	Buy	
June 2007	275,351	271,516	145,659	125,856	814	766	48	0	0	0	3,004	3,004	0	24	24	0	
Dec. 2007	389,231	381,945	201,893	180,053	820	820	0	0	0	0	6,427	6,344	83	35	35	0	
June 2008	562,222	554,209	293,839	260,371	631	631	0	0	0	0	7,342	7,179	163	42	42	0	
Dec. 2008	390,160	382,398	203,409	178,989	349	349	0	0	0	0	7,201	6,853	348	215	215	0	
June 2009	894,196	887,258	451,942	435,316	384	374	10	0	0	0	5,662	5,280	382	890	270	620	
Dec. 2009	1,029,791	1,022,922	525,688	497,235	522	512	10	0	0	0	5,661	5,258	403	689	114	575	
June 2010	1,116,517	1,110,430	561,026	549,404	207	196	11	0	0	0	5,344	4,874	470	537	119	418	
Dec. 2010	1,144,710	1,137,088	577,434	559,653	2,001	1,101	900	0	0	0	5,215	4,745	470	407	125	282	
June 2011	1,157,661	1,151,538	579,602	571,934	278	266	12	0	0	0	5,642	4,915	727	204	136	68	
Dec. 2011	1,116,847	1,111,618	553,655	557,963	195	182	13	0	0	0	4,649	4,068	581	386	199	187	
June 2012	1,105,389	1,098,891	547,638	551,253	209	196	13	0	0	0	6,038	3,933	2,105	252	107	145	
Dec. 2012	1,047,913	1,040,915	529,454	511,462	473	374	99	0	0	0	6,302	3,510	2,792	226	93	133	
June 2013	1,061,005	1,055,262	536,826	518,436	542	143	399	130	65	65	4,868	1,838	3,030	203	86	117	
Dec. 2013	853,899	848,494	427,571	420,923	455	119	336	0	0	0	4,815	1,815	3,000	132	75	57	
June 2014	785,138	778,255	389,898	388,358	367	123	244	0	0	0	5,999	2,316	3,683	514	455	59	
Dec. 2014	710,060	703,689	356,398	347,292	261	104	157	0	0	0	5,664	2,471	3,193	444	394	50	
June 2015	563,687	552,855	280,527	272,330	4,415	2,260	2,155	0	0	0	6,144	2,864	3,280	270	221	49	
Dec. 2015	518,641	507,140	261,156	245,986	4,313	2,101	2,212	0	0	0	6,967	3,591	3,376	223	173	50	
June 2016	510,693	505,278	255,136	250,141	5,414	2,054	3,360	0	0	0	—	—	—	—	—	—	
Dec. 2016	441,444	437,525	219,801	217,721	3,918	1,522	2,396	0	0	0	—	—	—	—	—	—	
June 2017	410,941	406,401	203,375	203,025	4,537	1,804	2,733	0	0	0	—	—	—	—	—	—	

Note: Figures for credit-linked notes and other products that were included in credit derivatives have not been released since 2016.
Source: Compiled based on the data on chronological coefficients in Bank of Japan, “A Survey of Regular Market Reports Concerning Derivatives Trading.”
(<http://www.boj.or.jp/en/statistics/bis/yoshi/index.htm/>)

CHAPTER IX

The Securitized Products Market

1. What Is a Securitized Product?

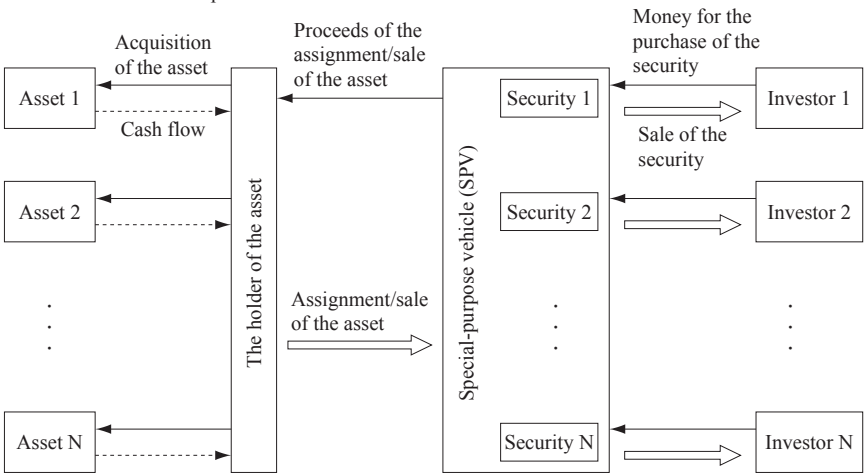
The income-generating assets of a company are pooled separately from its balance sheet into a special-purpose vehicle (SPV), and the SPV issues a security backed by the cash flow to be generated by such assets and sells the security to investors. This method is called “securitization.” The security issued through such a process is generally called a “securitized product.” Business enterprises use their assets—such as auto loans, mortgage loans, leases receivable, business loans and such claims as loans to corporations, and commercial real estate—as collateral to back up their securitized products. As defined by the Act on Securitization of Assets, intellectual property (such as copyrights and patents) also can be securitized.

When viewed from the standpoint of asset holders, securitization of assets has the advantage of enabling them to use the proceeds of the assignment or sale of such assets that they obtain at the time of issue in exchange for cash flows that may be generated by the assets over a future period of years. In other words, asset holders can monetize uncertain future cash flows into current income. In addition, in case any holder of a piece of less-liquid commercial real estate wants to issue a security by putting up such real estate as collateral, such asset holder may easily sell the security by issuing it in small denominations to attract a larger number of small investors, thereby increasing liquidity.

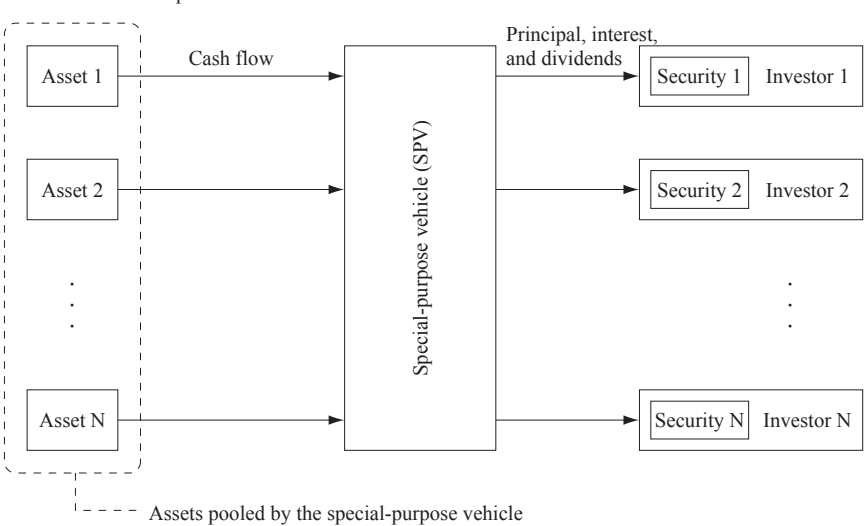
When viewed from the standpoint of investors, securitized products give them an additional choice of investments that have a new character. More specifically, a security backed by a piece of real estate gives them an opportunity to invest in real estate that otherwise they cannot afford to buy outright with a small sum of money. Second, as asset holders can issue different classes, or tranches, of securities (“the senior/subordinated structure”) at one and the same time with varying levels of credit risks, they offer investors the opportunity to purchase a security that meets their needs. The issuers of asset-backed securities—Security 1 to Security N in Chart IX-1—simply tailor their terms of issue to best suit the needs of Investor 1 to Investor N, instead

Chart IX-1. Conceptual Chart of Securitized Products

At the time a securitized product is issued



After the securitized product has been issued



of making them uniform. For instance, by issuing securities with different characters—differentiation of the order of priority for the payment of interest and redemption of principal or granting credit-enhancing conditions (credit enhancement)—the scope of choice for investors can be enlarged. By adding such new wrinkles, investors can restructure their portfolios into more efficient ones.

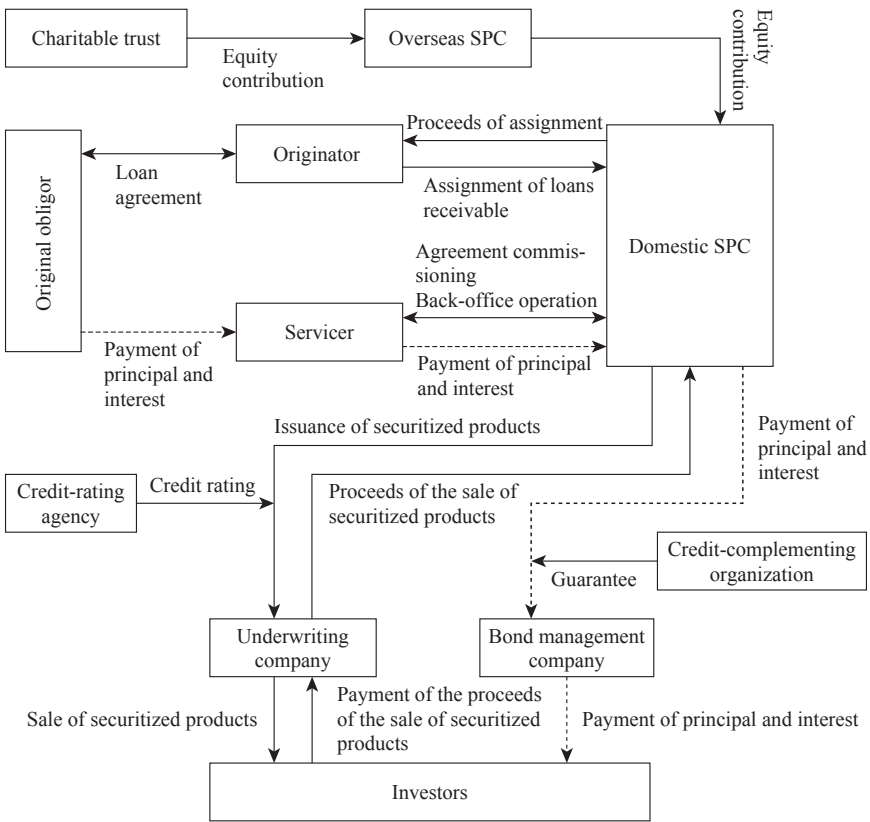
2. Basic Mechanism of Issuing Securitized Products

Generally, many of the securitized products are issued through the mechanism described below. First, the holder of assets (“originator”) such as mortgage loans and accounts receivable that are to be securitized assigns them to a SPV. By doing so, such assets are separated from the balance sheet of the originator and become assets of the SPV, which becomes the holder of the assets. An SPV may take the form of a partnership, a trust, or a special-purpose company (SPC). An SPC established under the Act on Securitization of Assets is called *tokutei mokuteki kaisha* (TMK, or a specific-purpose company). To ensure bankruptcy remoteness (no impact even if the company, etc., held by the SPC goes bankrupt), an overseas SPC is generally set up as a subsidiary through what are called charitable trusts under U.S. and U.K. laws using what is termed a “declaration of trust,” and the domestic SPC established as a subsidiary of the overseas SPC. In terms of originators, the entity responsible for the debt is called the original obligor.

The next step is to formulate the terms of issue of the securitized product to be issued by the SPV. If the originator opts for the trust method, it issues beneficiary certificates like those of a trust company. If it chooses the SPC method, it issues the kinds of securities decided upon by the SPC to provide securitized products to investors, but it does not have to issue them on one and the same terms of issue. In short, it can design each type (tranche) of security with a different character by differentiating the order of priority with respect to the payment of interest and redemption of principal, by varying maturities, or by offering the guarantee of a property and casualty insurance company. By adding such variation, the originator can issue securities that meet the diverse needs of investors. In the order of priority for payment, such securities are called “senior securities,” “mezzanine securities,” or “subordinated securities.”

When the originator plans to sell its securitized products to an unspecified large number of investors, it should make them readily acceptable to investors by offering them objective and simple indicators (credit ratings) for independently measuring the risks involved. In addition, there are other players involved in different processes of securitized products, such as servicers, who

Chart IX-2. Example of General Working Mechanism for Issuing Securitized Products



manage assets that have been assigned to an SPV and securitized and also recover funds under commission from the SPV, and bond management companies, which administer the securitized products (corporate bonds) purchased by investors. Firms that propose such a mechanism for securitizing assets and that coordinate the issuing and the sale of such products are called “arrangers,” and securities companies and banks often act as arrangers.

3. Description of Major Securitized Products

Securitized products are divided into several groups according to the types of assets offered as collateral and the character of the securities issued. Those belonging to the group of products that are backed by real estate and the

Table IX-1. Classification of SPVs

Types	SPVs established under basic laws	SPVs established under special laws
Corporation type	Special-purpose company (SPC) Domestic: – Corporation (Companies Act) Overseas: – SPC (foreign governing law)	Specific-purpose company–TMK (Act on Securitization of Assets) Investment corporation (Act on Investment Trusts and Investment Corporations)
Trust type	General trust (Trust Act and Trust Business Act)	Specific-purpose trust (SPT) (Act on Securitization of Assets) Investment trust (Act on Investment Trusts and Investment Corporations)
Partnership type	Silent partnership (Commercial Code), general partnership (Civil Code)	Silent partnership, general partnership (Act on Specified Joint Real Estate Ventures)

Source: Prepared by the author from various materials.

claims collateralized by it are residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and real estate investment trusts (REIT). RMBSs are issued in retail denominations against a portfolio that pools home mortgage loans. The first securitized product based on residential mortgage loans was the residential mortgage loan trust launched in 1973. However, this product failed to attract the attention of both issuers and investors because of too much limitation. Nevertheless, as the scheme based on SPC became available thereafter, thanks to the enforcement of the SPC Law, the volume of this type of issue has increased since 1999. Although bonds backed by housing loans that have been issued by the Japan Housing Finance Agency since 2001 were not issued through an SPC, they may be included among the RMBSs. CMBSs are backed by loans given against the collateral of commercial real estate (office buildings, etc.). The mechanism of issuing them is almost the same as that for RMBSs. The REIT that became available by virtue of enforcement of the Act on Investment Trust and Investment Corporation in May 2000 is an investment trust in that it can only invest in assets backed by real estate.

Another group consists of asset-backed securities (ABS, narrowly defined), such as accounts receivable, leases receivable, credits, auto loans, and consumer loans, etc. Sales of these products began to increase in the latter half of 1990s following the enforcement of the Specified Claims Law in June 1993. As these collateralized assets are a collection of relatively small assets and can be dispersed, they are highly suitable for securitization. What is more, as the laws governing the products have since been developed, they are securitized more extensively than the real-estate-backed group.

Table IX-2. Description of Major Securitized Products

Underlying claims	Securities issued	Originator	Governing laws	Basic scheme
Housing loans receivable	Residential mortgage-backed securities	Banks Other banking institutions	Act on Securitization of Assets, Trust Business Act, Financial Instruments and Exchange Act	A banking institution that holds mortgage credits assigns them to an SPC; the SPC, in turn, issues a bond backed by such credits or entrusts them to a trust bank, which, in turn, issues beneficiary certificates backed by them.
	Japan Housing Finance Agency bonds backed by housing loans receivable (RMBS)	Japan Housing Finance Agency	Act on the Japan Housing Finance Agency, Independent Administrative Agency Financial Instruments and Exchange Act	Housing loans receivable held by the Japan Housing Finance Agency are given in trust to a trust bank, and a specified corporate bond backed by the beneficiary certificates of a trust is issued at that time through an SPC.
Commercial mortgage credits and rental revenues	Commercial mortgage-backed securities (CMBS)	Business corporations, Banks Other banking institutions	Act on Securitization of Assets, Trust Business Act, Financial Instruments and Exchange Act	The originator assigns the commercial mortgage credits and rental revenues, etc., to an SPC; the SPC, in turn, issues a bond backed by such credits or entrusts them to a trust bank, which, in turn, issues beneficiary certificates backed by them.
	Real estate-specific joint venture products	Authorized or registered firms	Act on Specified Joint Real Estate Ventures	An equity contribution is invited from a large number of retail investors, and the funds thus pooled are jointly invested in real estate by taking advantage of the scheme of a voluntary association, an anonymous association, or a real estate investment trust.
Real estate	Real estate investment trusts (REIT)	Owners of property purchased by an investment trust	Act on Investment Trusts and Investment Corporations Financial Instruments and Exchange Act	An investment corporation issues units of investment and purchases a piece of real estate and real estate loan claims with the proceeds of such units in accordance with instructions given by a management company.
	Mortgage securities	Mortgage securities companies	Mortgage Securities Act Financial Instruments and Exchange Act	Mortgage securities are issued by registering mortgage loan receivables of the mortgage securities company, and jointly held equity in mortgage securities is sold to investors.
Fiscal Loan Fund loan receivables	Fiscal Loan Fund loan-backed securities	Government	Act on Securitization of Assets, Financial Instruments and Exchange Act	The government entrusts the loan receivables from its Fiscal Loan Fund to a trust company. Beneficiary certificates issued on the loans are then sold to an SPC, which issues securities with the loans as the underlying assets.
	Leases receivable, credit card receivables, and installment credit accounts and notes receivable	Business corporations	Act on Securitization of Assets, Trust Business Act, Financial Instruments and Exchange Act	A business corporation that holds lease credits assigns them to an SPC; the SPC, in turn, issues a bond backed by such credits or entrusts them to a trust bank, which, in turn, issues beneficiary certificates backed by them.
General loans	Collateralized loan obligations (CLO)	Banks	Act on Securitization of Assets, Trust Business Act, Financial Instruments and Exchange Act	A banking institution that holds general loans assigns them to an SPC; the SPC, in turn, issues a bond backed by such loans or entrusts them to a trust bank, which, in turn, issues beneficiary certificates backed by them.
Bonds	Collateralized bond obligations (CBO)	Banks and other bondholders	Act on Securitization of Assets, Trust Business Act, Financial Instruments and Exchange Act	The banks and other bondholders that hold a number of bonds assign them to an SPC; the SPC, in turn, issues a bond backed by such credits or entrusts them to a trust bank, which, in turn, issues beneficiary certificates backed by them.

Other securitized products are called collateralized debt obligations (CDO), which are securities issued against the collateral of general loans, corporate bonds, and credit risks of loans that are held by banking institutions. For instance, loans to small and medium-sized business enterprises that are securitized may be considered CDOs. And CDOs are subdivided into collateralized loan obligations (CLO) and collateralized bond obligations (CBO). Moreover, since the eligibility requirements for issuing commercial paper (CP) were abolished in 1996, an increasing number of business corporations have come to use asset-backed commercial paper (ABCP) as a form of securitized product.

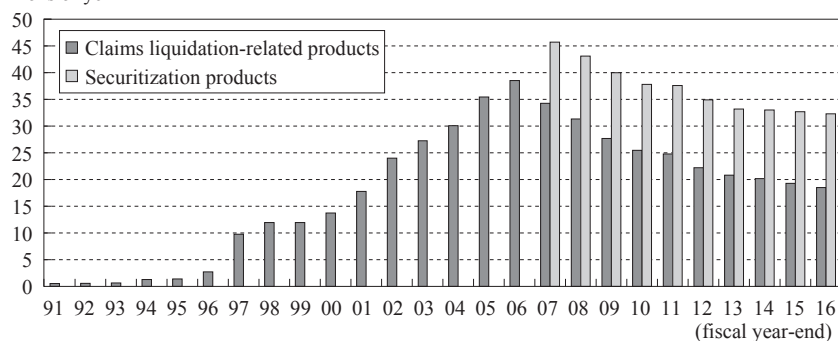
4. The Size of the Market

In 2011, the Bank of Japan announced retroactively balances for securitized products back to the end of fiscal 2007, which were previously unavailable figures. According to these statistics, the balance of securitized products outstanding as of the end of fiscal 2016, stood close to ¥33 trillion. When compared with that of stocks and beneficiary certificates of investment trusts (¥1,261 trillion), loans by private financial institutions to corporations and government entities (¥614 trillion), industrial bonds (¥77 trillion) and bank debentures (¥10 trillion), their share of private-sector financing as a whole is still not very large. In contrast, a similar balance (of ABS and mortgage-related combined) in the United States, which is considered the most advanced nation in securitizing claims, stood at about ¥1,100 trillion at the end of fiscal 2016. The total issuance amount came to ¥240 trillion, reflecting the extraordinary size of the market compared to the Japanese one.

The scale of the securitized products market that stood at a mere ¥400 billion at the end of fiscal 1989 increased sharply thanks to the enforcement of the Specified Claims Law in 1993 (repealed in 2004), the Special Purpose Companies Law in 1998 and the Act on Securitization of Assets, which is a revised version of the Special Purpose Companies Law, in 2000. This also suggests that assets that can be used as collateral have diversified and that asset securitization has found a growing number of applications. Looking back, the issuance of securities backed by installment credits, which was made possible by the enactment of the Specified Claims Law, was the engine of growth of the market. As these assets have short maturities and can be readily pooled for diversification, they carry relatively low risks and can be securitized, and such attributes have been a factor in expanding the scale of the market for them. Since 2000, following the enforcement of the Act on Securitization of Assets, the securitization of mortgage loans, as well as of loans to business corporations and the government, has expanded dramatically.

Chart IX-3. The Balance of Securitized and Claims Liquidation-Related Products

trillions of yen



FY	91	92	93	94	95	96	97	98	99	00	01	02	03
Asset-liquidation products	0.5	0.6	0.7	1.3	1.4	2.7	9.8	11.9	11.9	13.7	17.8	24.0	27.2
Securitized Products	-	-	-	-	-	-	-	-	-	-	-	-	-
FY	04	05	06	07	08	09	10	11	12	13	14	15	16
Asset-liquidation products	30.1	35.5	38.5	34.2	31.3	27.7	25.5	24.8	22.2	20.8	20.2	19.3	18.5
Securitized Products	-	-	-	45.7	43.1	40.0	37.8	37.6	34.9	33.2	33.0	32.7	32.3

Source: Compiled on the basis of the data drawn from *Nichigin shikin junkan-tokei* (Flow-of-Funds Statement of the Bank of Japan).

Table IX-3. Changes in Composition of Collateralized Assets, etc.

	(trillions of yen)						
	2011	2012	2013	2014	2015	2016	Ratio to net operating income
Asset backed bonds (ABB)	14.2	13.8	13.6	13.8	14.4	14.6	45.1
MBS issued by JHFA	10.1	10.6	10.9	11.0	11.7	12.1	37.3
ABB backed by real estate properties	2.7	2.1	1.6	1.6	1.7	1.7	5.2
Other ABB	1.4	1.2	1.1	1.2	1.0	0.8	2.5
ABCP	2.6	2.3	1.9	1.8	1.7	1.7	5.2
Trust beneficiary rights	20.8	18.8	17.7	17.4	16.7	16.0	49.4
Of which backed by housing loans	8.5	7.7	7.6	7.6	7.8	7.7	23.8
Of which backed by loans to companies and governments	2.3	1.9	1.6	1.7	1.6	1.7	5.2
Of which backed by accounts receivable	5.8	5.1	4.4	3.6	2.7	1.7	5.2
Of which backed by lease and consumer credits	3.5	3.2	3.0	3.3	3.7	4.1	12.7
Total	37.6	34.9	33.2	33.0	32.8	32.4	100.0

Source: Compiled based on the data from *Nichigin shikin junkan-tokei* (Flow-of-Funds Statement of the Bank of Japan).

This may be explained by the fact that, pressed by the need to raise the capital adequacy ratio in compliance with the Basel Accords, banks have sought to unload loan assets from their balance sheets. After reaching a peak in fiscal 2006, the volume of securitized products has gone into decline under the impact, etc., of the weakening of the economy set off by the subprime loan crisis.

“Securitized products” are defined as the total of asset-backed securities, asset-backed commercial paper (ABCP) and trust beneficiary interests. Residential mortgage-backed securities (RMBS) issued by the Japan Housing Finance Agency (JHF; formerly, Housing Loan Corporation) account for no less than 80% of asset-backed securities. Looking at the underlying assets of trust beneficiary interests that account for nearly half of the total outstanding balance, nearly 50% are mortgage loans while almost 25% are leases & credit receivables.

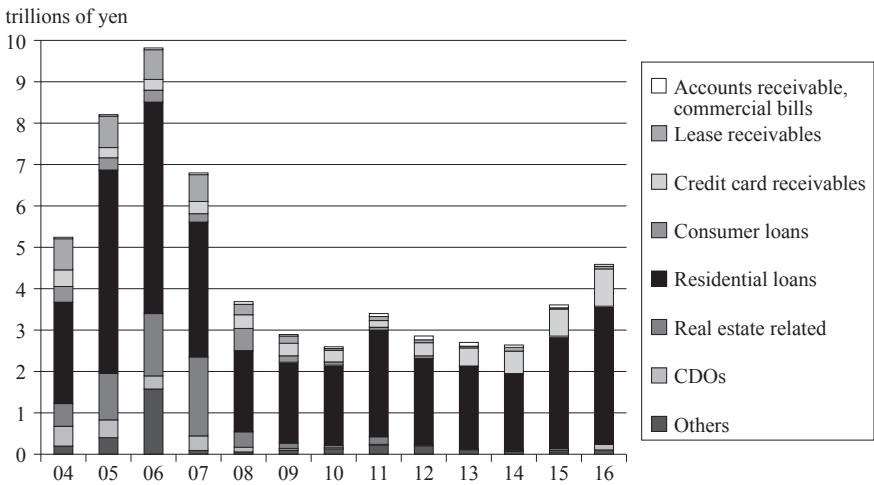
5. Primary Market for Securitized Products

As the bulk of securitized products are issued in private placement transactions between the parties concerned, it is difficult to accurately grasp the size of the primary market of securitized products. However, the Japan Securities Dealers Association (JSDA) currently compiles and publishes the “Securitization Market Trends Survey” conducted jointly with the Japanese Bankers Association based on information on issuance trends of securitized products received voluntarily from arrangers of securitized products and others. According to the Securitization Market Trends Survey, securitized products issued in Japan in fiscal 2016 reached ¥4.5 trillion. Although securitized product issuance reached a peak of ¥9.8 trillion in fiscal 2006, it went through a period of decline under the impact of the weakening economy kicked off by the subprime loan problem. However, it has been on a recovery trend over the last few years.

Looking at the trend by the type of asset pledged as collateral, while residential mortgage loans and shopping credits have exhibited a recovery trend, other assets have declined—a result that reflects the differences in the types of underlying assets. Residential mortgage loans account for a further increasing percentage of the underlying assets used as collateral, a trend that has not changed over the past few years. This trend reflects that lending banks are actively securitizing mortgage loans of their own origination and that the issuance of RMBS by the Japan Housing Finance Agency has remained at a high level.

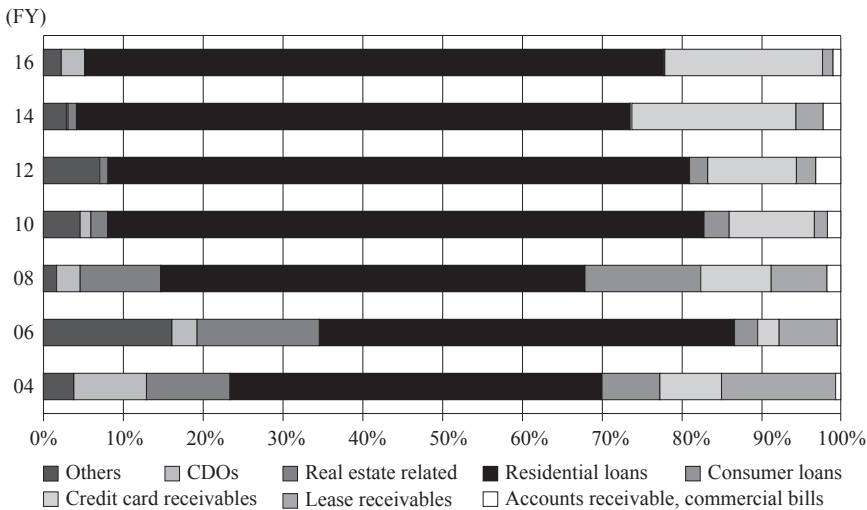
According to the data on issuance compiled by the JSDA, the total value of publicly offered asset-backed corporate bonds had steadily increased since

Chart IX-4. Securitized Products Issuance



Source: Securitization department of Deutsche Securities Inc.

Chart IX-5. Breakdown of Collateralized Assets



Source: Securitization department of Deutsche Securities Inc.

1997, the year in which the association started tracking the data. After hitting a peak of ¥0.52 trillion in fiscal 2002, however, the total has declined, falling to ¥0.1 trillion in fiscal 2016. The popularity of privately placed asset-backed corporate bonds is thought to be the result of considerations with regard to investor protection framework, taxes, and disclosure cost.

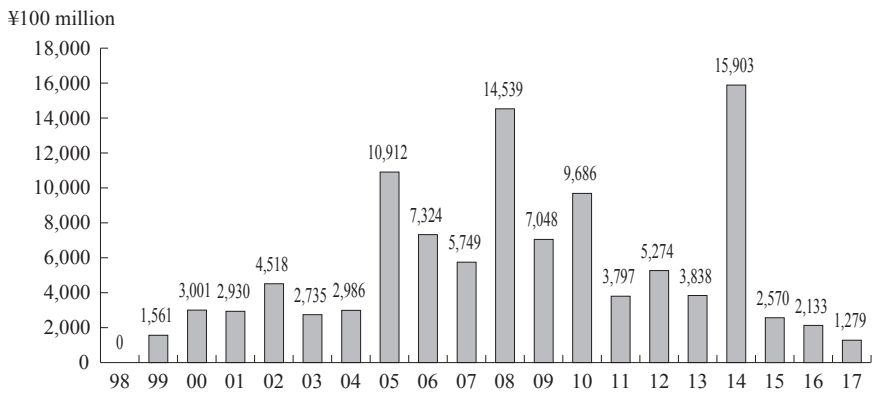
The underwriting of these securitized products is concentrated in major brokers/dealers and bank-affiliated securities companies. According to Thomson-Reuters Corporation, a major information provider, the Mizuho Financial Group accounted for a 40% share in the securitized products underwriting market in 2016. Other top underwriters of those securitized products were Sumitomo Mitsui Financial Group (over 11% share) and Mitsubishi UFJ Morgan Stanley (nearly 9% share), followed by Nomura Holdings, Daiwa Securities Group and Goldman Sachs. Although the list has shown some movement over the past few years, it has been minor. It may be said that the results reflect their capabilities in distributing securitized products and procuring collateral assets, as well as securitization expertise that meets client needs.

6. Secondary Market for Securitized Products

With the exception of beneficiary certificates of real estate investment trusts (REITs) and infrastructure funds to be discussed later, trading in securitized products is not concentrated in stock exchanges. As is the case with the secondary market for bonds, securitized products and their transactions are too complex and varied to lend themselves to exchange trading. Hence this has led to the dependence on an over-the-counter interdealer market as the secondary market for their trading. In this section, we will overview the present state of the interdealer market of securitized products by using primarily the data on “TMK bonds” (which are publicly offered corporate bonds issued by a corporation established based on the Act on Securitization of Assets. Asset-backed bonds, which is an item for statistics for the primary market includes the portion of the issuer established for funds raising purposes based on the Companies Act.) published by the JSDA, which is in a position to obtain data on interdealer transactions.

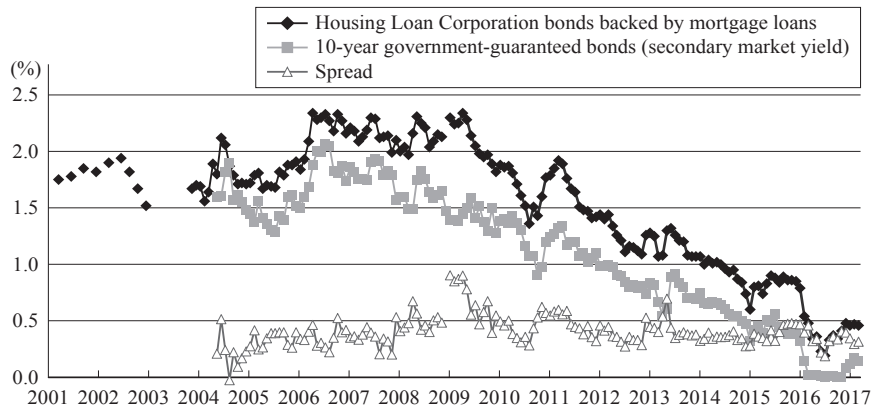
Data on the trading amounts of TMK bonds compiled by the JSDA on the basis of reports from member securities companies for the years prior to 1998 are not available. According to these reports, the trading amount of TMK bonds has fluctuated frequently, reaching a peak in 2014. A comparison of TMK trading amounts with those of other bonds in 2017 shows that TMK bond trading amounted to nearly ¥130 billion, and those of corporate straight bonds and utility bonds stood at ¥17.3 trillion and ¥3.2 trillion, respectively.

Chart IX-6. The Amount of TMK Bonds Traded



Source: Compiled on the basis of the data drawn from the Japan Securities Dealers Association.

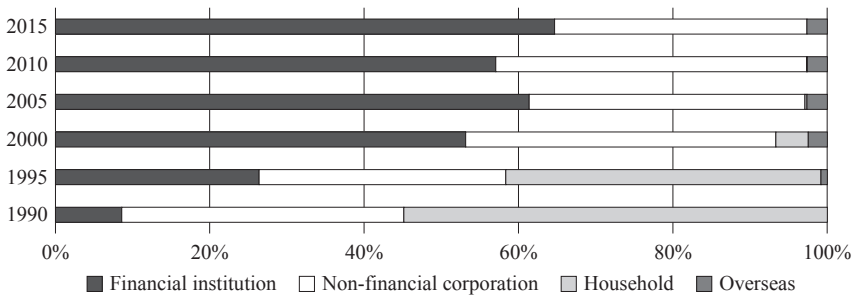
Chart IX-7. Yield to Subscribers of the Housing Loan Corporation Bonds



Source: Compiled on the basis of the data drawn from *Kinyu keizai tokei geppo* (Monthly Report on Financial and Economic Statistics) of the Bank of Japan.

Although these issues constitute only a part of the securitized products market, it may be said that the asset-backed securities market of this country still remains underdeveloped. The number of securities companies that offer them is quite limited, and their liquidity is considerably low. On the other hand, a large number of securities companies make a market in RMBS issued by the Japan Housing Finance Agency, the bonds are classified as FILP agency

Chart IX-8. Claims Liquidation-Related Product Holding Ratio



Source: Compiled on the basis of the data drawn from *Nichigin shikin junkan-tokei* (Flow-of-Funds Statement of the Bank of Japan).

bonds for statistical purposes, and their market seems to have a certain degree of liquidity.

As their trading market is yet to attain maturity, it is difficult to precisely measure their secondary market yields, and they have to be substituted with yields at issue. Measured in terms of yields at issue, the most highly liquid JHF bonds are traded at a higher yield than government-guaranteed bonds. Reinvestment risk occasioned by early mortgage loan repayment in addition to the expected redemption period and the availability of a government guarantee may be a factor behind this. While the spread of these two bonds can slightly widen at times, it is generally stable at no more than 0.5%.

According to the balance of financial assets and liabilities of the Flow-of-Funds Accounts of the Bank of Japan, most of the holders of credit liquidation-related products (securitized products) currently are nonfinancial corporations and banking institutions. In 1990, households were the primary holders. Since then, however, holdings by households have declined consistently, and currently stand at zero. Meanwhile, during this time, financial institutions increased their holdings of securitization-related products and have become the primary holders.

7. Primary and Secondary Markets for the Beneficiary Certificates of Real Estate Investment Trusts

On September 10, 2001, the Japan Building Fund Investment Corporation and the Japan Real Estate Investment Corporation listed their certificates on the Tokyo Stock Exchange and became the first public real estate investment trusts (REITs) in Japan. These real estate investment trusts owe their creation

Table IX-4. The Listing Requirements of the Tokyo Stock Exchange

Item	Listing requirements
Eligibility for becoming an asset management company	The investment trust management company, the trust company for an investment trust without instruction by trustor, or an entity that otherwise manages assets of a REIT applying for listing must be a member of the Investment Trusts Association, Japan.
Ratio of real estate to the total value of assets managed	The ratio of real estate is expected to be 70% or higher.
Ratio of real estate and related assets and liquid assets to the total assets under management	The ratio of real estate is expected to be 95% or higher.
Total net asset value	Expected to increase to ¥1 billion or more by the time of listing.
Total asset value	Expected to increase to ¥5 billion or more by the time of listing.
Auditor's opinion	(a) The securities report for the two immediately preceding terms are fair and accurate and contain no false statements. (b) The audit reports for the two immediately preceding terms contain the remarks "unqualified opinion" or "qualified opinion with an exception."
No. of units listed	Expected to increase to 4,000 or more by the time it is listed.
Major beneficiaries or investors	The total number of units owned by major beneficiaries or investors is expected to be 75% or less of the total units listed.
No. of beneficiaries or investors	Their number (except major beneficiaries or investors) is expected to increase to 1,000 or more at the time of listing.

Source: Compiled on the basis of the data drawn from the website of the Tokyo Stock Exchange.

to the amendment of the Securities Investment Trust Act enforced in November 2000, which makes it possible to form trust funds through a real estate investment trust scheme. In addition, the Tokyo Stock Exchange instituted a rule granting a special exception to the securities listing regulations in favor of real estate investment trust certificates and enforced it on March 1, 2001. By December 31, 2016, the number of listed issues had increased to 59.

The basic mechanism of REITs is this: investment corporations or investment managers called investment trust management companies pool funds of investors, invest such funds primarily in real estate, and distribute the investment income (including rent income) to investors. The three types of securities defined in the Act on Investment Trusts and Investment Corporations—beneficiary certificates of investment trusts with instruction by trustor, beneficiary certificates of investment trusts without instruction by trustor, and investment securities of investment corporations—may also be issued by real estate investment trusts. The first type of trust is managed by a trust

Table IX-5. Statistics Relating to REITs Listed on the Tokyo Stock Exchange

Calendar year	No. of issues listed	Total net asset value (¥100 million)	Trading volume (in 10,000 units)	Amount of certificates traded (¥100 million)
2001	2	2,314		810
2002	6	4,451	46	2,061
2003	10	7,088	100	5,057
2004	14	11,062	182	11,791
2005	26	18,937	297	20,551
2006	39	29,539	472	35,040
2007	41	35,910	811	74,428
2008	40	38,405	779	39,926
2009	40	38,733	618	22,423
2010	35	38,811	881	26,645
2011	34	40,211	1,058	28,664
2012	37	43,644	1,384	32,213
2013	45	53,200	3,570	87,800
2014	51	62,364	4,099	79,369
2015	52	73,482	4,658	100,284
2016	57	82,954	6,478	128,113

Source: Compiled based on the data available in the “Statistics on Real Estate Investment Companies” issued by The Investment Trusts Association, Japan and other materials.

company that holds the assets in custody in accordance with instructions given by the management company. The second type is managed by a trust bank in accordance with its own judgment. And the third is commissioned to a management company by the investment corporation that holds the assets. All of the certificates of the REITs listed on the Tokyo Stock Exchange are investment securities issued by investment corporations.

One of the advantages investors can derive from REITs is that they are able to invest in real estate with a small amount of money, and they can enjoy liquidity in freely trading their investments in the market. Another is that REITs offer diversification to their investment portfolio. REIT dividends may be expensed provided that a REIT meets certain requirements, including distributing more than 90% of its income to its certificate holders.

One problem that the managers of REITs have to address is the possibility of a conflict of interests between investors and the manager of a REIT with respect to any investment of its assets commissioned to a third party. In other words, it is feared that the management company may force the REIT to buy

a piece of real estate held by its stockholders at a high price. To avoid the occurrence of such a situation, it is desirable to require the REIT to fully disclose information concerning its investments. And investors should consider getting involved in the management of investment corporations through a general meeting of investors.

8. Listed Infrastructure Funds

In April 2015, the Tokyo Stock Exchange (TSE) established an infrastructure fund market for listing funds that invest in infrastructure properties. The infrastructure funds handled on this market hold infrastructure properties and attain a cash flow that arises when lending the assets to operators. It is on the infrastructure fund market that the securities issued as underlying instruments of the cash flow are traded.

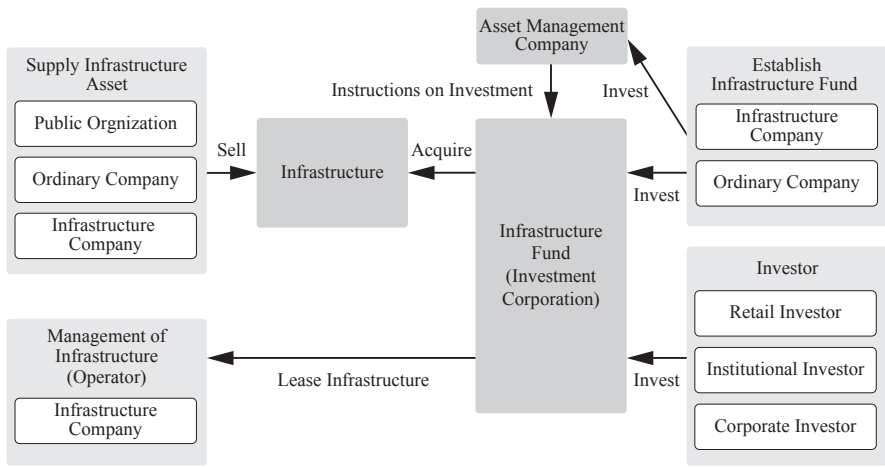
The structure of infrastructure funds is basically similar to that of REIT. While the listing rules for the infrastructure fund market are generally based on the framework for the REIT market, there is a key difference in that the policy for selecting operators who borrow and operate the infrastructure properties is included in the rules.

Since the infrastructure fund market was established only recently, only four issues have been listed, two in 2016, and two in 2017. In addition, all listed issues hold solar power generation facilities as underlying assets and have issued securities. This is likely due to the projection that a solar power plant would be a highly stable source of profits given that power companies buy power at fixed prices following the enforcement of the Act on Special Measures Concerning Procurement of Electricity from Renewable Energy Sources by Electricity Utilities (“Feed-in Tariffs (FIT) Act”) in 2011.

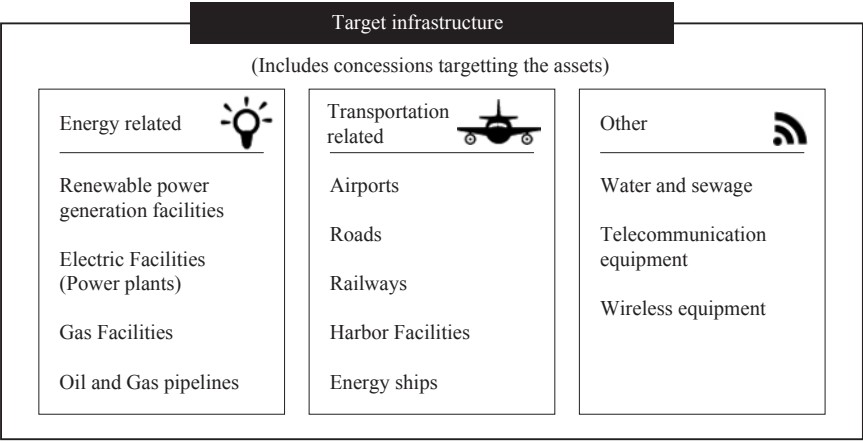
Properties that support the livelihoods of people, including electricity and gas facilities, water supply facilities, railroads and roads, can be the underlying assets of infrastructure funds. One of the reasons why infrastructure funds have been drawing attention is because earnings generated by such infrastructure properties are considered to be relatively less vulnerable to economic changes. This makes it possible for infrastructure funds to also maintain stable profits. While currently in Japan all funds pertain to solar power plants, it is anticipated that infrastructure funds that invest in other types of properties will emerge going forward.

The total number of shares issued for the four issues combined amounts to approximately 200,000 shares. Daily trading volume on the market in October 2017 stood at nearly 1,300 shares combined for the three issues that were listed at the time. Also drawing attention is the future development of trading on the market.

Chart IX-9. Structure of Infrastructure Funds



Source: Website of the Japan Exchange Group, Inc.



* Right to operate public facilities (concession) refers to the right to operate the public facility, which collects charges for usage that can be outsourced to a private business operator while the ownership of the facility remains with the public entity.

Source: "Infrastructure Funds" Section on the website of the Japan Exchange Group, Inc.

In infrastructure investment, the terms greenfield and brownfield are used. The former signifies a field that has not been touched by human hands, reflecting a type of investment made where nothing exists. Meanwhile, the latter refers to a state in which human intervention has already been made, reflecting an investment in an existing infrastructure facility.

9. Risks and Credit Enhancement of Securitized Products

As the structure of securitized products is complex, credit rating is widely used as a criterion for making an investment decision. And in order to package assets into a securitized product that merits a high credit rating, a device for controlling various risks has to be built into the product. The substance of risks varies depending on the kind of underlying assets and the participants in the scheme, but one thing in common among them is the default risk, or the probability that the issuer may fail to pay its interest or principal promptly when due. The default risk of a securitized product is largely divided into two kinds: the risk of changes occurring in the cash flow generated by the underlying assets (bad debt or arrears) and the risk of bankruptcy of parties involved in the securitization of assets (the debtor, the SPC, or the originator).

The risk involved in the cash flow may be reduced by taking various credit-enhancing measures. Unlike general corporate bonds, whose credit rating is determined by the credit risk of their issuers, the credit rating of a securitized product must be based on the results of examinations of assets underlying each product. The arranger who underwrites and markets the securitized product and the originator negotiate with a credit-rating agency to obtain a high rating. There are various credit-enhancing measures to choose from for different schemes employed for issuing a securitized product, but they may be largely divided into two: an external credit-enhancing measure that utilizes external credit (such as banking institutions) and an internal credit-enhancing measure that gives the structure of the security the function of enhancing its credit. There are two methods of external credit enhancement: indirect and direct. The former complements cash flows from underlying loan assets, and the latter complements that of a securitized product. The indirect method has a drawback in that it cannot eliminate risks associated with a servicer or any other party involved in securitization. As a means of enhancing internal credit, a senior subordinated structure is commonly used. In Japan, however, the subordinated securities are often held by the originator because, among other reasons, there are few investors who are willing to purchase them.

A large part of the risk of changes in cash flows from underlying assets can be covered by credit enhancing measures. However, the risk of bankrupt-

Table IX-6. Main Credit Enhancing Measures

Credit enhancement (external)	Recourse of the originator	The originator owes recourse to a certain part of the assets sold to the SPC. Off-balance sheet accounting may not be authorized depending on the extent to which the originator owes such recourse.
	Credit default swaps	The purchaser of a swap pays a certain amount of money in premium in exchange for a guarantee of credit risk of a specified claim.
	Guarantee, insurance by financial institutions	A property and casualty insurance company provides insurance covering the entire default risk is issued securities.
Credit enhancement (internal)	Spread account	The balance of funds remaining after deducting the amounts paid to the investors and fees from the cash flow of the underlying assets is deposited in a spread account to be used as compensation money in case of default.
	Over collateral	The credit standing of securities is enhanced by selling such part of the underlying assets whose value is in excess of the amount of the securities issued to the special purpose vehicle (SPV).
	Senior/subordinated structure	By designating part of the securities issued as subordinated debt, the credit standing of the rest of the issue is enhanced.

cy of the parties involved in securitization is a serious problem. As assigned claims and receivables of a bankrupt originator are typically subject to bankruptcy proceedings, investors carry the risk of nonpayment of their principal and interest. Therefore, it is important to check whether there is any risk in the business of any party concerned or whether the party is shielded from the risk of other parties concerned. Risks are complexly intertwined, and they are summed up in Table IX-7.

10. The Enactment of Securitization-Related Laws

The existing legal system of Japan is built around business-specific laws, and the regulatory system of financial instruments is vertically divided along the lines of business-specific laws. As these laws contain many provisions regulating or banning business activities outright, it was pointed out that to spur the development of new business, such as the securitization of assets, the existing laws have to be amended, and new laws must be enacted.

As regards the securitization of assets, pioneered by the Mortgage Securities Act introduced in 1931, the Specified Claims Law was enacted as an independent law in 1993. Since the enforcement of this law, the legal infrastructure has been developed steadily. Under and thanks to the Specified

Table IX-7. Typical Risks of ABS

Overall risks of ABS	Outline	Measures necessary to avoid risks
Credit risk	There is a risk of a failure to generate an expected cash flow due to a default of the originator.	A review of credit-enhancing measures is needed. In the case of an underlying asset that consists of many credits, steps must be taken to diversify such underlying assets.
Prepayment risk	If the issuer redeems the security ahead of its maturity, the investors will be exposed to prepayment risks.	It is necessary to develop techniques such as a collateralized mortgage obligation (CMO) and a security with a period of deferment that adjusts the relationship between the underlying assets and the cash flow generated by the security issued thereby.
Liquidity risk	When the funds flow out rapidly from the market, the holder cannot sell the security in a timely manner because the liquidity of the securitized product is not adequate, and the holder is thus exposed to a liquidity crunch.	The development of a secondary market for trading ABSs is a must. Also, the subordinated security should be traded widely among the investors.
Risks of the parties concerned	Outline	Measures necessary to avoid risks
Originator's risk	Once the claims of the originator sold to the SPC are recognized as part of the bankruptcy estate, the investors have the risk of forfeiting their right to receive the payment of the principal and interest of the security.	It is necessary to ensure that the transfer of the claims is not for securing a loan but is their true sale. The assets must be separated from the balance sheet. Transaction must have the conditions necessary for counteracting against a third party.
Servicer risk	The commingling risk: A servicer of receivables that went bankrupt may mingle the funds it had received before it went bankrupt with its own funds without remitting them to the SPV.	The designation of a backup servicer capable of putting up excess collateral is needed. Payment of remittances received from debtors must be made directly into the account of the SPV. Management of a lock-box account must be conducted.
SPC risk	Bankruptcy remoteness must be established so that the SPC of an asset securitization scheme itself will not go bankrupt or will not be affected by the bankruptcy of other companies.	The substance of business must be clearly defined, and an SPC in which the originator has no equity interest must be founded by establishing a charitable trust. The commencement of bankruptcy proceedings must be averted by making the charitable trust its beneficial shareholder.

Table IX-8. Chronology Relating to the Securitization of Assets

Month & Year	Changes implemented
Aug. 1931	The Mortgage Securities Act is enacted.
June 1973	Housing loan companies raise funds by offering beneficiary certificates of housing loan claim trusts.
Sept. 1974	Housing loan companies raise funds by offering mortgage-backed securities.
Jan. 1988	The Law Concerning the Regulation of Mortgage-Backed Securities Business is enforced.
Apr. 1992	The Law Concerning the Regulation of Business Relating to Commodity Investment (the Commodity Fund Law) is enforced.
Apr. 1993	The Securities and Exchange Act designates beneficiary certificates of housing loan claim trusts as securities.
June 1993	The Law Concerning the Regulation of Business Relating to Specified Claims, etc. (the Specified Claims Law) is enforced.
July 1993	The ban on the issuance of CPs by nonbanks is lifted.
Apr. 1995	The Act on Specified Joint Real Estate Ventures is enforced.
Apr. 1996	As a method of liquidizing assets under the Securities and Exchange Act, the issuance of asset-backed securities (ABS and ABCP) is authorized, making it possible to issue them other than under the Securities and Exchange Act.
June 1997	Beneficiary certificates of general loan claim trusts (including loans secured by real estate) are designated as securities under the Securities and Exchange Act.
Feb. 1998	The Securities Investment Trust Act is amended (and the ban on corporation type investment trusts and privately placed investment trusts is lifted).
Apr. 1998	A total plan for the liquidation of land and claims is announced.
Sept. 1998	The Act on Securitization of Specified Assets by Specified Purpose Companies (the SPC Law) is enforced.
Oct. 1998	The Law Concerning Exceptions to Requirements under the Civil Code for the Perfection of Assignment of Receivables and Other Properties (the Perfection Law) is enforced.
Jan. 1999	A statement of opinion on establishing accounting standards for financial instruments is published. (The financial component approach to conditional transfer of financial assets is adopted.)
Feb. 1999	The Act on Special Measures Concerning Claim Management and Collection Business (the Servicer Law) is enforced.
May 1999	Act on Issuance, etc. of Bonds for Financial Corporations' Loan Business (the so-called Nonbank Bond Law) is enforced.
Nov. 2000	With the enforcement of the Act on Securitization of Assets, the scope of assets eligible for securitization is expanded to include a broad range of property rights.
Nov. 2000	The Act on Investment Trusts and Investment Corporations (the revised Securities Investment Trust Act) is enforced, expanding the assets that can be securitized to real estate, etc.
Sept. 2001	The revised Act on Special Measures Concerning Claim Management and Collection Business is enforced.
Dec. 2004	The Trust Business Act is amended, and the system requiring trust companies of the management type to register is launched.
Dec. 2004	The Specified Claims Law is repealed.
Oct. 2005	The Special Provisions of Assignment of Obligations was amended to the Act on Special Provisions, etc. of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims.
May 2006	The Companies Act is enforced.
Dec. 2006	The Trust Act is amended and provided for business, personal, and purpose trusts.
Oct. 2007	The Financial Instruments and Exchange Act is enforced.
Nov. 2011	Revised Act on Securitization of Assets is enforced.

Claims Law, the liquidation and securitization of assets classified as specified claims, such as leases receivable and credit card receivables, started. Thereafter, various laws were enacted to help the banking institutions meet the capital adequacy standards imposed by the Basel Committee on Banking Supervision and to encourage the securitization of their assets to deal with the bad loan problem that had become serious since the turn of the decade of the 1990s.

Under the Special-Purpose Company (SPC) Law and the Act on Securitization of Assets enacted as the revised SPC Law, structures incorporating SPVs, including specific-purpose companies (TMK) and specific-purpose trusts (SPT), may be used for securitizing specified assets designated in the provisions of the said laws (real estate, designated money claims, and beneficiary certificates issued against such assets in trust) in the form of asset-backed securities (such as senior subscription certificates, specified corporate bonds, and specified promissory notes, etc.). Under the SPC Law, the system of disclosing an asset liquidation plan and individual liquidation projects was introduced, in addition to the disclosure requirements on the disclosure of information on securities under the Securities and Exchange Act (currently the Financial Instruments and Exchange Act).

In 1998 the Act on Special Provisions, etc. of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims was enacted as a law prescribing exceptions to requirements under the Civil Code for the perfection of the assignment of receivables and other properties, and it was amended in 2005. The Civil Code provides the legal requirements for the assertion of the assignment of nominative claims (claims with named creditors) against obligors or third parties. Designated claims were transferable, but the provisions of the Civil Code had been a major hurdle standing in the way of securitizing them. And the Perfection Law set forth simple procedures for the perfection of such interests.

The Act on Special Measures Concerning Claim Management and Collection Business, enacted to account for exceptions to the provisions of the Attorney Law, allows accredited corporations to provide the services of administering and collecting debts. Under the Act on Special Measures Concerning Claim Management and Collection Business, a debt collection company may be established to provide a bad debt collection service without conflicts with the Attorney Law. The Act on Issuance, etc. of Bonds for Financial Corporations' Loan Business conditionally lifted the ban imposed on nonbanks on the issuance of corporate bonds and CPs for the purpose of raising capital for lending operations and on ABSs.

As a result of the revision of the Securities and Exchange Act based on the Act on Revision, etc. of Related Acts for the Financial System Reform and the enforcement of the Financial Instruments and Exchange Act, beneficiary

certificates of and trust beneficiary interests in assets that are deemed eligible for securitization by the provisions of the Act on Securitization of Assets and mortgage certificates under the Mortgage Securities Act are now legally considered securities. Furthermore, pursuant to the enactment of the Act on Investment Trusts and Investment Corporations as revised, real estate was included in eligible assets, which paved the way for the issuance of REIT securities. Since then, the scope of eligible assets has been expanded, and the infrastructure funds emerged.

CHAPTER X

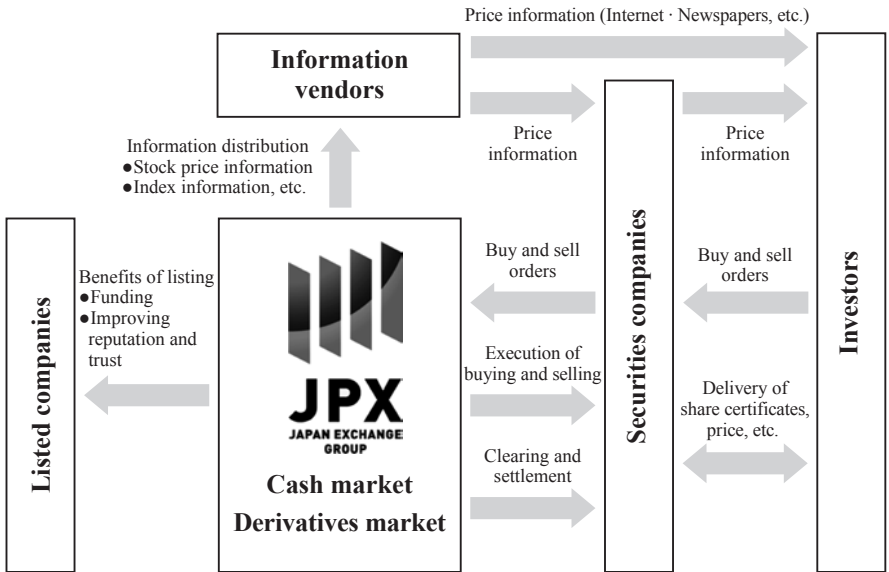
Financial Instruments Exchange, etc. (1)

1. The Function of the Financial Instruments Exchanges

The basic function of a financial instruments exchange (stock exchange) is to establish a highly organized market and concentrate supply and demand of marketable securities in a single market to enhance the liquidity of securities, to help form fair prices that reflect supply and demand, and to promptly publish the prices thus formed. The purpose of a financial instruments exchange is to establish a market for trading securities and executing exchange derivatives trading and to run the market in such a way as to facilitate fair and efficient trading in the public interest and for the protection of investors. The basic mission of the financial instruments exchange is to provide a fair and transparent market. The market established by a financial instruments exchange has the function of providing a marketplace that enhances the liquidity of financial instruments and helps form fair prices so as to provide investors with an environment in which investors can conduct investment activities free from anxiety, raise funds smoothly by issuing securities, and hedge risks by executing exchange derivatives trading among other activities. Furthermore, prices formed on an exchange can serve as a base for assessing the asset value of securities among others and price indexes serve as an important indicator of economic and business trends. Because financial instruments exchanges operated by stock exchanges perform an important role in supporting the economy of the nation, a license must be obtained from the prime minister to open an exchange, and the operation of that exchange is placed under supervision according to the Financial Instruments and Exchange Act.

Stock exchanges were conventionally required to be membership organizations under the Securities and Exchange Act. An amendment of that law that went into effect in 2000, however, allowed stock exchanges to change their legal status to that of a corporation. Starting with the Osaka Securities Exchange (OSE) in 2001, the Tokyo Stock Exchange (TSE), Nagoya Stock Exchange, and JASDAQ reorganized as corporations. The enforcement of the Financial Instruments and Exchange Act in 2007 provided for the establishment by an exchange of an exchange holding company, self-regulatory

Chart X-1. The Function of the Financial Instruments Exchanges



[Corporate Philosophy of Japan Exchange Group, Inc.]

“Our mission is to contribute to the realization of an affluent society by promoting continuous development of the market by ensuring our public nature and credibility, constructing the foundation of the market which is highly convenient, efficient and transparent, and providing creative and attractive services. Our efforts bring rewards in the form of profits resulting from the increased support and confidence of investors and other market users.”

[Purpose of the Tokyo Stock Exchange, Inc.]

Articles of Incorporation Article 2

1. The purpose of the Company shall be to conduct the following business:

- (1) Providing market facilities for securities trading, publicizing market prices and quotations, ensuring fairness of securities trading and other business regarding operation of the financial instruments exchange market
- (2) Designating numbers to identify parties in a financial instruments transaction (excluding trading in financial instruments exchange markets)
- (3) Business incidental to the business mentioned in the preceding two items

2. The Company shall conduct its business, placing the highest value on ensuring securities trading is executed in a fair and smooth manner, thereby contributing to the public interest and the protection of investors.

corporation, etc. Given this revised law, in the same year, the Tokyo Stock Exchange Group, Inc. was established as a holding company of the Tokyo Stock Exchange and a self-regulatory corporation. The establishment of a holding company was prompted by potential conflicts of interest between the public role of an exchange as an operator of self-regulating operations and the for-profit orientation of an exchange as a corporation, where exchanges sought to reinforce the independence of their highly public function to ensure self-regulation of the market. Furthermore, against the backdrop of intensifying competition among markets across borders resulting from the advancement of financial transaction systems, in 2013, the Tokyo Stock Exchange Group and the Osaka Securities Exchange combined their operations to increase the appeal and convenience of their markets and to enhance their global competitiveness, forming the Japan Exchange Group (JPX).

2. The Listing System

The stock exchange imposes listing requirements from the viewpoint of investor protection and examines the listing applications of securities companies to see whether they satisfy the listing requirements. The listing requirements comprise formal and eligibility requirements. After the stock exchange receives an application from a company wishing to list its stock, the exchange checks first whether or not the listing applicant meets the formal requirements and then the eligibility requirements.

The formal requirements include (1) those relating to the number of shareholders; tradable shares (number of shares owned by shareholders other than large shareholders and other specified persons, market value of tradable shares, ratio of tradable shares); and market capitalization of the shares listed from the standpoint of ensuring smooth trading in shares and forming fair prices; (2) those relating to the number of years of business operation; shareholders' equity; and the amount of Profits earned from the standpoint of maintaining the suitability for listing in terms of continuity of business, financial position, and profitability, etc.; those relating to financial statements, audit comments and audits by a registered listed company audit firm from the standpoint of ensuring appropriate disclosure of companies' activities; and also those relating to the appointment of a transfer agent, the tangen trading unit, the classes of shares, restricted shares, and appointment of a designated custody and transfer agent from the standpoint of preventing forgeries and other troubles in the share transfer process as well as ensuring smooth operation in connection with transactions.

Meanwhile, the eligibility requirements are: (1) corporate continuity and profitability, (2) soundness of corporate management, (3) effectiveness of

Table X-1. The Listing Requirements of the Second Section of the Tokyo Stock Exchange
(as of September 2017)

Formal Requirements	
Amount of net assets ¹⁾ (Expected at listing)	Consolidated: ¥1 billion or more (plus positive value for non-consolidated net assets)
Amount of profit ²⁾	Consolidated: ¥500 million or more for the most recent two years
No. of shareholders ³⁾ (Expected at listing)	800 or more
Tradable shares ⁴⁾ (Expected at listing)	a. No. of tradable shares: 4,000 units or more ⁵⁾ b. Market value of tradable shares: ¥1 billion or more c. Ratio of tradable shares: 30% or more of the listed stocks
Market capitalization of the shares listed (Expected at listing)	¥2 billion or more
No. of years of business operation	Three years or more in continuous operation with a board of directors in place, calculated from the end of the prior business year
Financial statements	The financial statements for the latest two years contain no false statements
Auditor's opinion	"Unqualified opinion" or "qualified opinion" for the latest two years "Unqualified opinion" for the latest year
Others	Audited by a registered listed company audit firm ⁶⁾ Appointment of a shareholder services agent Number of shares in Tangen trading units; class of stocks Restriction on stock transfer Appointment of designated custody and transfer agent

- Notes: 1. Amount of net assets = Total net assets + Reserves – Subscription rights/warrants (indicated in the section of net assets).
2. The amount of profits is the amount derived by adding or subtracting minority interests in subsidiaries to/from the amount of current profit (loss). If market capitalization of the shares listed is ¥50 billion or more (excluding when net sales in the latest year amounted to less than ¥10 billion), there is no need to meet the standard on the amount of profits.
3. No. of shareholders means the number of shareholders who own one or more units of shares.
4. "Tradable shares" refers to listed shares excluding shares held by parties with a special interest such as officers, shares owned by the company itself, and shares held by persons who individually own 10% or more of listed shares.
5. One unit is the number of shares that constitute one unit.
6. An audit firm that is registered in the registry of listed company audit firms based on the Registration System for Listed Company Audit Firms of the Japanese Institute of Certified Public Accountants (including audit firm which is subject to quality control reviews by the Japanese Institute of Certified Public Accountants).

(as of September 2017)

Eligibility Requirements
[Corporate continuity and profitability] A business is operated continuously and a stable revenue base is present.
[Soundness of corporate management] The company is carrying out business in a fair and faithful manner.
[Effectiveness of corporate governance and internal management system of an enterprise] Corporate governance and internal management system are properly prepared and functioning.
[Appropriateness of disclosure of corporate information, etc.] The company is in a status where disclosure of corporate information, etc. may be carried out in an appropriate manner.
Other matters deemed necessary by the Exchange from the viewpoint of the public interest or the protection of investors.

corporate governance and internal management system of an enterprise, (4) appropriateness of disclosure of corporate information, etc., and (5) other matters deemed necessary by the stock exchange from the viewpoint of the public interest or the protection of investors. Examination of fulfillment of these eligibility requirements is made on the basis of the documents submitted by, and hearings conducted on, the issuing company.

A company newly listing on the First or the Second Section of the market is first listed on the Second Section, and when it meets the listing requirements for the First Section it is allowed to transfer to the First Section. However, if the company is judged to be capable of meeting the formal listing requirements of having 2,200 or more shareholders, 20,000 units or more of tradable shares, a ratio of tradable shares of 35% or more, and a market capitalization of ¥25 billion or more by the time it actually lists, it will be allowed to list directly on the First Section.

3. The Listing Management System

With a view to carrying out the proper management of listed securities and to protecting investors, stock exchanges have instituted various rules relating to the management of listings and have sought to ensure the effectiveness of these rules by requiring issuers to promise to observe them in the listing agreement they sign at the time of listing.

In the case of the Tokyo Stock Exchange, its listing requirements include rules requiring listed companies to make timely disclosure of information regarding any material corporate matters, a code of corporate conduct requiring companies to adhere to appropriate behavior, and rules concerning changes in market section classification and the delisting of securities.

Rules Requiring Timely Disclosure of Material Corporate Matters: To ensure the formation of fair market prices and to foster the sound development of a financial instruments market, it is extremely important for listed companies to make proper disclosure in a timely manner of information concerning material corporate matters that may influence the investment decision-making of investors, the very basis on which stock prices are formed. The Tokyo Stock Exchange has established rules as part of its listing requirements for listed companies to make timely disclosure of material corporate information.

Code of Corporate Conduct: The Tokyo Stock Exchange has introduced a code of corporate conduct. The multifold purposes of requiring proper conduct by listed companies are to raise awareness of their role as members of the financial instruments market, to ensure greater transparency by enhancing the disclosure of corporate information, and to achieve the proper operation

Table X-2. Outline of Code of Corporate Conduct of the Tokyo Stock Exchange

(as of September 2017)

Matters to be observed (if a listed company violates a provision regarding these matters, it may be subject to measures enforced by the TSE)	Matters desired to be observed (listed companies are expected to make efforts to observe them)
<ul style="list-style-type: none"> • Matters to be observed regarding third-party allotment • Prohibition of stock split, etc., that could cause turmoil in the secondary market • Matters to be observed pertaining to issuance of MSCB, etc. • Duty to exercise of voting rights in writing, etc. • Duty to carry out framework improvement to facilitate exercise of voting rights for listed foreign companies • Duty to secure an independent director/auditor • Duty to explain the reasons for implementing or not implementing the Corporate Governance Code • Duty to appoint a board of directors, an audit board or committee, and an accounting auditor • Duty to select a certified public accountant or public audit firm to provide the audit certificate of the accounting auditor • Duty to carry out necessary structural development of a system for ensuring the appropriateness of business • Matters to be observed pertaining to introduction of takeover defense measures • Matters to be observed pertaining to disclosure of MBOs, etc. • Matters to be observed pertaining to significant transactions, etc., with controlling shareholders • Audit by an audit firm placed on the TSE's Listed Company Audit Firm Register • Prohibition of insider trading • Exclusion of anti-social forces • Prohibition of behavior destructive to the functioning of the secondary market or the rights of shareholders 	<ul style="list-style-type: none"> • Efforts toward the shift to and maintenance of the desired investment unit level • Efforts toward unification of trading unit • Respect for the principles of the Corporate Governance Code • Securing management structure that includes independent directors • Framework improvement to enable proper functioning of independent directors/auditors • Provide information on independent directors/auditors, etc. • Framework improvement to facilitate exercise of voting rights • Delivery of documents to shareholders owning stock without voting rights • System improvement for prevention of occurrence of insider trading • Development of system, etc. for excluding anti-social forces • Development of systems and structures to properly respond to changes in accounting standards, etc. • Fair provision of supplementary explanatory materials on details of account settlement

of investor protection measures and market functions.

Changing Section Classifications: The Second Section of the Tokyo Stock Exchange was established separately from the First Section in 1961 initially with a view to better protecting investors with regard to problems with being attracted from the then immature over-the-counter market into the exchange market. At present, the principal difference between the First and Second Sections is generally perceived as liquidity. The Tokyo Stock Exchange's listing requirements stipulate the criteria for assignment to the First Section and the criteria for reassignment from the First Section to the Second Section.

Criteria for Delisting Stocks: A stock may be delisted whenever it meets any of the conditions set forth in the criteria for delisting stocks in the listing

Table X-3. Criteria for Delisting Stocks (Tokyo Stock Exchange)

(as of September 2017)

Item	Outline
① No. of shareholders	Less than 400 (with a grace period of one year)
② Tradable shares	When any of a through c corresponds: a. No. of tradable shares: less than 2,000 units (with a one-year grace period) b. Market value of tradable shares: less than ¥500 million (with a one-year grace period) c. Ratio of tradable shares: less than 5% of listed stocks
③ Trading volume	Either the average monthly trading volume over the past one year is less than ten units or no trades were made for the past three months
④ Market capitalization of the shares listed	When market capitalization of the shares listed falls below of ¥1 billion and does not increase to ¥1 billion or above within nine months ¹⁾
⑤ Liabilities	If the issuer's liabilities exceed assets and this state remains unchanged for one year ²⁾
⑥ Bankruptcy, etc.	When an issuer becomes insolvent or falls into a situation requiring rehabilitation or reorganization proceedings, or in situations equivalent thereto ³⁾
⑦ Suspension of business activities	When a listed issuer suspends its business activities or falls into a situation similar thereto
⑧ Inappropriate mergers	When the stock exchange determines that a listed company that acquired another company has in effect failed to survive the merger and that the surviving company has failed to meet standards equivalent to the initial listing requirements within three years of such merger
⑨ Deterioration in soundness of transactions with controlling shareholder	When the stock exchange determines that there has been a marked deterioration in the soundness of transactions between the company and its controlling shareholder within three years of a change in the controlling shareholder due to a third-party allotment
⑩ Delays in securities filings	When a listed issuer fails to file an annual or quarterly securities report together with an auditor's report or quarterly review report within one month following the statutory deadline (if an extension of deadline has been approved for filing, when the listed issuers fails to file within 8 days following that deadline)
⑪ False statements or adverse opinion	<ul style="list-style-type: none"> • When a false statement is made in a securities report, etc. and the competent stock exchange finds that maintaining order on the exchange could be difficult without immediate delisting of the issue • When an audit report contains an improper opinion or no auditors' opinion and the competent stock exchange finds that maintaining order on the exchange could be difficult without immediate delisting of the issue
⑫ Securities on Alert	<ul style="list-style-type: none"> • When despite the issue meeting criteria to be designated as securities on alert, the competent stock exchange determines that there is no likelihood of improvement in the issuing company's internal control system, etc. • When during the process of designating the issue as securities on alert, the competent stock exchange determines that there is no likelihood of improvement in the issuing company's internal control system, etc. • When despite having designated the issue as securities on alert, the competent stock exchange determines that there is no likelihood of improvement in the issuing company's internal control system, etc.
⑬ Breach of the listing agreement	When a listed company seriously violates the listing agreement or pledge concerning timely disclosure or when it becomes no longer a party to the listing agreement
⑭ Undue restrictions on shareholders' rights	When shareholders' rights or exercise thereof are unduly restricted (Example) Introduction of a rights plan without contingency, introduction of a dead hand-type rights plan, issuance of a golden share (classified stock with veto power), etc.
⑮ Others	Suspension of a listed issuer by the bank, failure to appoint a shareholder services agent, certain restrictions on share transfers, becoming a wholly owned subsidiary of another company, cancellation of the custody and transfer agent agreement, wholly call, involvement with antisocial groups, and when the competent stock exchange finds that the delisting of a given stock is in the public interest or appropriate for the protection of investors

Notes: 1) Three months in the case that a document indicating the current business status, future development, improvement of business plan, etc. is not submitted.

2) The grace period is extended for another year if such issuer has a credible plan to wipe out the negative net worth within a year after the grace period through rehabilitation proceedings.

3) Excluding a case where a reconstruction plan is disclosed and market capitalization for a period of one month is ¥1 billion or above.

requirements.

When any stock is in danger of falling within the purview of the criteria for delisting stocks, the issue will be put on the watch list to notify general investors. When any stock actually falls within the purview of the delisting criteria, the issue will be put on the liquidation list to publicize the information and allow the trading of such issue to continue for a specified period (ordinarily one month).

4. The Corporate Governance Code

Application of the Corporate Governance Code: Following the government's growth strategy "Japan Revitalization Strategy (Revised in 2014)," the Corporate Governance Code, a set of key principles that contribute to realizing effective corporate governance of listed companies (hereafter, the Code), has been applied to listed companies from June 2015.

The Code consists of a total of 73 principles, including general principles, principles, and supplementary principles, and adopts the "comply or explain" (either comply with the principles or explain the reasons for non-compliance) approach. The scope in which the requirements under the "comply or explain" approach are imposed differ depending on the market category. In the case that a company listed on the First or the Second Section of the existing markets chooses to not comply with any of the 73 principles and in the case that a company listed on Mothers or JASDAQ chooses not to comply with any of the five basic principles, the company must explain the reasons for non-compliance.

Furthermore, since it would be desirable for companies to disclose and explain matters in a standardized framework, the status of adoption of the Code by listed companies is to be described in the Corporate Governance Report, which the listed companies are required to submit, and the Corporate Governance Report is made available on the website of the respective stock exchange, etc. for public inspection.

Response to the Corporate Governance Code: Looking at the status as of July 2017, out of the 2,544 companies listed on the First and Second Sections of the market, 663 companies (26.1%) complied with all 73 principles and 2,262 companies (88.9%) complied with 90% or more of the principles. As a consequence of reviews conducted by each of the listed companies in consideration of the Corporate Governance Code, the compliance rate has been on the rise. In terms of individual principles, the compliance rate showed a significant increase particularly for Supplementary Principle 4-11.3 (Evaluation of effectiveness of the board), an increase of 35.0 basis points from the level at the end of December 2015 immediately after the adoption

Chart X-2. Overview of the Corporate Governance Code

<ul style="list-style-type: none">• Formulated as part of the growth strategy, the Code seeks “growth-oriented governance” that contributes to demonstrating healthy corporate entrepreneurship• The Code calls for the enhancement of corporate value through appropriate cooperation with not only shareholders but also with a variety of stakeholders• Shareholders with medium- to long-term holdings have the potential to become important partners for companies and the Code encourages sufficient constructive dialogue between companies and their shareholders ⇒ Promotes sustainable corporate growth and increased mid- to long-term corporate value of companies, thereby contributing to the development of overall economic growth	
<ul style="list-style-type: none">• Principles-Based Approach: Review activities against the aim and spirit of the principles, not against the literal wording and statement in judging whether or not the activities are truly appropriate• Comply-or-Explain: The Code adopts the approach of not requiring companies to comply with all of its principles uniformly since, unlike laws and regulations, the Code is not legally binding. Instead, the Code asks the companies to comply with a principle, or, if not, explain the reasons for non-compliance.	<p>[3. Information Disclosure] Companies should appropriately disclose information in compliance with the relevant laws and regulations, and ensure that such information is accurate, transparent and highly useful.</p>
<p>[1. Securing the Rights and Equal Treatment of Shareholders] Companies should take measures to fully secure rights and equal treatment of shareholders.</p> <ul style="list-style-type: none">• Securing the substantial rights of shareholders ⇒ Measures for giving shareholders sufficient time to consider the agenda of general shareholder meetings (early delivery of convening notices, etc.)• Cross-shareholdings ⇒ Disclosure of the shareholding policy, explanation of the objective and rationale for shareholding based on the examination of economic rationale, establishment and disclosure of standards for the exercise of voting rights	<p>[4. Responsibilities of the Board] In order to promote sustainable corporate growth and enhance earnings power and capital efficiency, the board should appropriately fulfill the following roles and responsibilities: (1) Setting the broad direction of corporate strategy; (2) Establishing an environment where appropriate risk-taking by the senior management is supported; and (3) Carrying out effective oversight from an independent and objective standpoint</p>
<p>[2. Cooperation with Stakeholders Other Than Shareholders] Companies should recognize that their sustainable growth is brought about as a result of contributions made by a variety of stakeholders, including employees, customers, business partners, and local communities, and should endeavor to appropriately cooperate with these stakeholders.</p> <ul style="list-style-type: none">• Appropriate response to issues surrounding sustainability, including social and environmental problems• Ensuring diversity, including active participation of women in companies	<p>◎ If a management decision causes unexpected damage to the company, there is a risk of a shareholder derivative lawsuit, etc. In such court cases, there is focus on the reasonableness of management’s decision-making process. ⇒ Supporting the company’s sound risk-taking</p> <ul style="list-style-type: none">• Use of independent/external directors that contribute to sustainable corporate growth ⇒ Appoint two or more persons who can contribute to constructive discussions ※ If a company in its own judgment believes it needs to appoint at least one-third of directors as independent directors, it should disclose a roadmap for doing so.
	<p>[5. Dialogue with Shareholders] In order to contribute to sustainable growth, companies should engage in constructive dialogue with shareholders.</p>

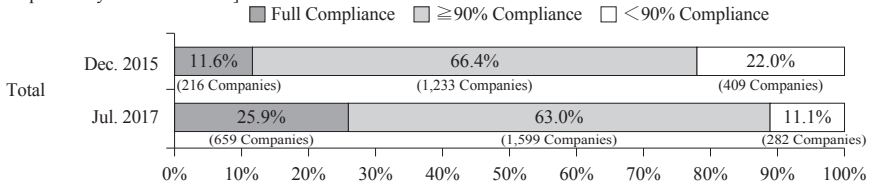
Source: Materials released by the Financial Services Agency.

of the Code, and General Principle 4-8 (appointment of at least two independent directors, etc.), an increase of 27.2 basis points.

Meanwhile, the principle with the highest explain rate was Supplementary Principle 1-2.4 (Creation of an infrastructure allowing electronic voting and provision of English translations of the convening notices of general shareholder meeting). Looking at the contents of explanations given, the majority indicated reasons underlying the intent to not comply with the respective

Chart X-3. Compliance with of the Corporate Governance Code (as of July 2017)

[Compliance by Market Division]



[Principles with which the “compliance” rate rose significantly]

Principles	“Compliance”	No. of companies. “Compliance”	No. of companies. “Explanation”	Compliance	Change from December 2015
Supplementary Principle 4-11.3	The board’s analysis and evaluation of its effectiveness and disclosure of a summary of the results	1,812	728	71.3%	+35.0pt
Principle 4-8	Appointment of at least two independent directors	2,153	387	84.8%	+27.2pt
Principle 3-1	Enhancement of disclosure of the following information (i) Company objectives (e.g., business principles), business strategies and business plans; (ii) Basic views and guidelines on corporate governance based on each of the principles of the Code; (iii) Board policies and procedures in determining the remuneration of the senior management and directors; (iv) Board policies and procedures in the appointment/dismissal of the senior management and the nomination of directors and auditor candidates; and (v) Explanations with respect to the individual appointments/dismissals and nominations based on iv.	2,349	191	92.5%	+20.6pt

[Principles with high “Explanation” rate]

Principle Contents	“Compliance”	No. of companies. “Compliance”	No. of companies. “Explanation”	Explanation
Supplementary Principle 1-2.4	Creation of an infrastructure allowing electronic voting, including the use of the Electronic Voting Platform, and the provision of English translations of the convening notices of general shareholder meeting	1,122	1,418	55.8%
Supplementary Principle 3-1.2	Bearing in mind the number of foreign shareholders, take steps for providing English language disclosures	1,794	746	29.4%

principle due to circumstances specific to their companies, such as the low percentage of foreign investors in the company's shareholder population.

5. The Stock Trading System (1)

A floor auction is the most widely used trading method on the stock exchanges. In the case of the Tokyo Stock Exchange, the trading hours are divided into two sessions: the morning session, from 9:00 a.m. to 11:30 a.m., and the afternoon session, from 12:30 p.m. to 3:00 p.m.

There are mainly two types of orders: a limit order, by which a customer limits the acceptable price, and a market order, which is executed immediately at the price available in the market without restrictions or limits. Limit orders can be made in such increments as ¥1 or ¥10, with the allowable price increments being determined according to the price range of the stock. Particularly for some highly liquid issues, more minute units of pricing are set for the purpose of improving contract prices and easing the wait until contract, and currently orders can be made even in increments of ¥0.1 (when the price is ¥1,000 or below). The allowable price for a limit order is restricted to a fixed price range based on the closing price of the previous trading day, which also controls any sharp movement in stock prices.

Trading of shares on the exchange floor is conducted in accordance with the price-priority rule (under which a buy/sell order with the highest/lowest bid/offer price takes precedence over the others) and the time-priority rule (when there is more than one order offering or bidding at the same price, the order placed the earliest takes precedence over others) and by either the *Itayose* method (single-price auction using an order book) or the *Zaraba* method (continuous auction).

Itayose method: The *Itayose* method is a system that is used to determine the opening or first price when trading commences or resumes on the floor. All buy and sell orders for a given issue are matched according to the price-priority rule to find a single price that clears all market orders and meets certain other conditions.

Zaraba method: The *Zaraba* method is a system by which, following the establishment of the opening price by the *Itayose* method, trades are executed in a continuous auction, in principle, through the end of a session. Through this method, a newly placed buy/sell order is matched against the existing sell/buy order that has the highest precedence based on price priority and then on time priority in order to determine the execution price.

Table X-4. Methods of Concluding Transactions

<i>Itayose</i> method			<i>Zaraba</i> method		
A memo (on a board) about an order received at the time an opening price is decided			A memo (on a board) about a <i>Zaraba</i> order for a given issue received		
(Asked price)	(Price)	(Bid price)	(Asked price)	(Price)	(Bid price)
H(2) I(4)	Market Quotation	K(1) M(3)		Market Quotation	
○○○	¥503		○○○	¥503	
○○○	¥502	T(1)	○○○	¥502	
○○	¥501	P(5) N(2)	○D(2) C(4)	¥501	
G(1) F(1) E(1)	¥500	A(4) B(3) C(2) D(1)	B(3) A(3)	¥500	
S(2)	¥499	○○○		¥499	F(3) G(2)○
R(4)	¥498	○○○		¥498	○○○
	¥497			¥497	○○○

Notes: 1. Alphabetical letters represent securities companies.

2. Figures given in parentheses represent the number of trading units, each consisting of 100 shares.

3. ○○○ are blanks to be filled with securities companies bidding or asking prices and the number of trading units.

4. In the case of the *Itayose* method, all bid and asked prices are considered to have been proposed simultaneously (simultaneous outcry).

The *Itayose* Method

- First, a sell order for 600 shares at a market-asked price without limit (200 shares by securities company H and 400 shares by securities company I) is matched against buy orders for 400 shares at a market-bid price without limit (100 shares by securities company K and 300 shares by securities company M). At this point, 200 shares at a market-asked price without limit are left unmatched.
- Then, assuming that the opening price will be ¥500, the remaining unfilled sell orders for 200 shares at a market-asked price without limit and those for 600 shares at an asked price of ¥499 or less (200 shares by securities company S and 400 shares by securities company R) are matched against buy orders for 800 shares at a bid price of ¥501 or more (500 shares by securities company P and 200 shares by securities company N and 100 shares by securities company T). As a result, sell orders for 1,200 shares at an asked price and buy orders for 1,200 shares at the bid price are matched.
- Lastly, a sell order for 300 shares at an asked price of ¥500 (100 shares by securities company E, 100 shares by securities company F, and 100 shares by securities company G) are matched against buy orders for 1,000 shares at a bid price of ¥500 (400 shares by securities company A, 300 shares by securities company B, 200 shares by securities company C, and 100 shares by securities company D). However, there are only 300 shares offered for sale at an asked price of ¥500, while there are buy orders for 1,000 shares at a bid price of ¥500. In such cases, all the sell orders for 300 shares at an asked price of ¥500 are matched against the buy orders for 100 shares each from securities company A, B, and C (for a total of 300 shares) at an asked price of ¥500. As a result, the opening price is decided at ¥500, and orders for a total of 1,500 shares are consummated at such price.

The *Zaraba* Method

- When the contents of an *Ita* (board) are as shown in the chart, a buy order of securities company M for 200 shares at a bid price of ¥500 can be consummated by matching the sell order of securities company A for 200 shares out of its original sell order for 300 shares.
- When securities company N places a buy order for 1,000 shares at a bid price without limit, it can be consummated by matching it against the remaining 100 shares offered for sale by securities company A at an asked price of ¥500 and a sell order of securities company B for 300 shares at an asked price of ¥500 and then a sell order of securities company C for 400 shares at an asked price of ¥501 and a sell order of securities company D for 200 shares at an asked price of ¥501.
- If securities company K places a sell order for 500 shares at an asked price of ¥499, a contract can be concluded by matching it against a buy order of securities company F for 300 shares at a bid price of ¥499 and a buy order of securities company G for 200 shares at a bid price of ¥499.
- As a result, the following trading agreements can be concluded

Selling securities company	Buying securities company	Contracted price	No. of shares
Securities company A	Securities company M	¥500	200 shares
Securities company A	Securities company N	¥500	100 "
Securities company B	Securities company N	¥500	300 "
Securities company C	Securities company N	¥501	400 "
Securities company D	Securities company N	¥501	200 "
Securities company K	Securities company F	¥499	300 "
Securities company K	Securities company G	¥499	200 "

- In such a manner, asked and bid prices are offered without interruption during the session hours, and when buy orders (sell orders) are matched against sell orders (buy orders), trading agreements are concluded.

6. The Stock Trading System (2)

Floor trading is the predominant form of securities trading conducted on the stock exchange. To complement the floor trading system, stock exchanges introduced off-floor trading systems in the second half of the 1990s.

During the initial period that followed the introduction of these systems, the systems were used solely for executing cross transactions (buy and sell orders by the same trading participant) due in part to the restriction that required orders to be placed via fax. However, the Tokyo Stock Exchange automated its off-floor trading system to improve efficiency and convenience with the introduction of ToSTNeT in June 1998 and expanded its trading system by adding new classes of transactions.

The Tokyo Stock Exchange has continuously improved this trading system to meet the various transaction needs of investors, including the extension of its trading hours in January 2008 and establishing it as an independent market from the trading floor.

ToSTNeT, the off-floor trading system of the Tokyo Stock Exchange, accommodates the following four types of transactions: single-stock trading, basket trading, closing-price trading, and off-floor corporate share repurchases.

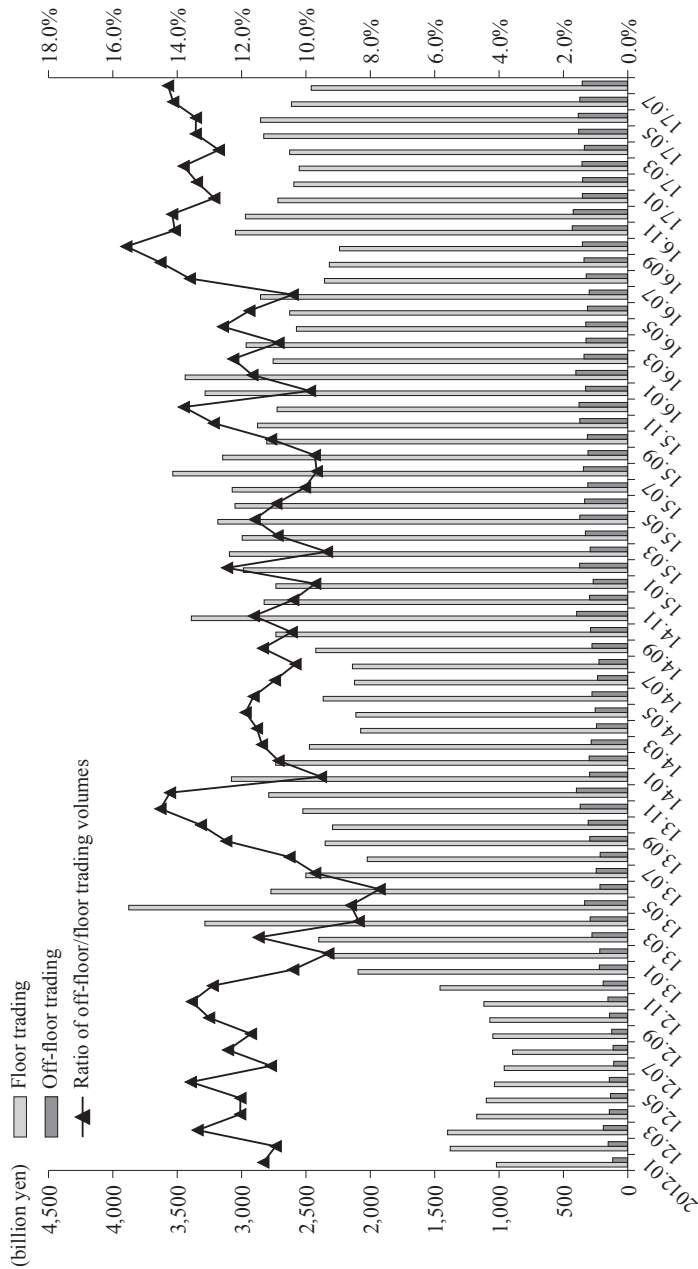
Single-Stock Trading: Under the single-stock trading system, investors can effect transactions in an individual stock issue at a price within plus-minus 7% (¥5 when 7% of the price is less than ¥5) of the last price of the issue on the floor or some other reference price as specified.

Basket Trading: The basket-trading system enables investors to trade baskets of a minimum of 15 stocks worth at least ¥100 million in aggregate value within plus-minus 5% of the value of the basket based on the last prices of the component issues on the floor or some other reference prices as specified.

Closing-Price Trading: Under the closing-price trading system, off-hour orders of investors are matched, in principle, based on time priority before the morning and afternoon sessions and after the afternoon sessions at the closing prices of the preceding session of floor trading (i.e., the closing prices of the previous day, those of the morning session, or those of the afternoon session) or some other reference prices as specified.

Off-Floor Corporate Share Repurchases: This is a method of trading shares off the floor before the morning session at the previous day's closing prices or some other reference price as specified. Buyers eligible for the facility are limited to listed companies that intend to repurchase their own shares.

Chart X-4. A Comparison of the Trading Value of Floor Trading and Off-Floor Trading of the Tokyo Stock Exchange



7. The Clearance and Settlement System (1)

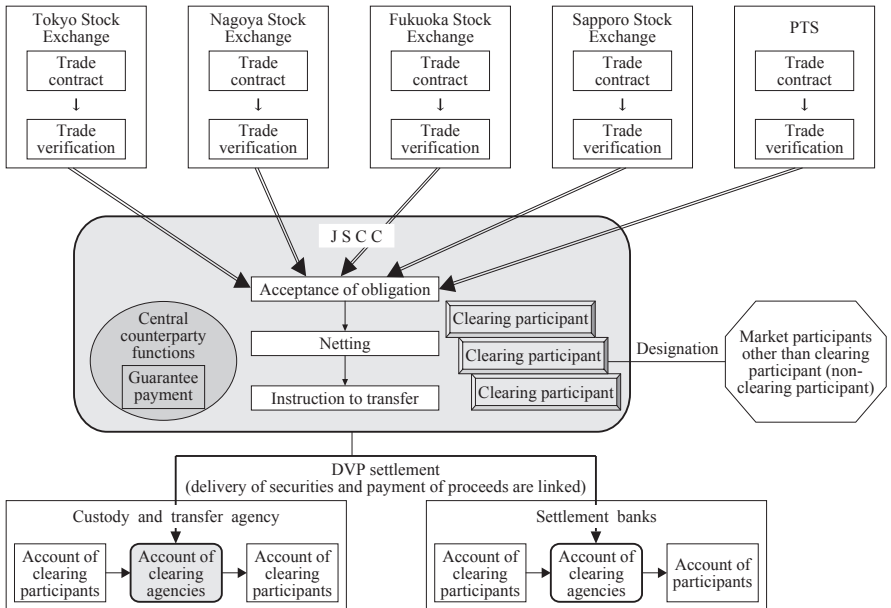
Securities trading executed on the exchanges is cleared and settled through the Japan Securities Clearing Corporation (JSCC). Since January 2003, all the clearing and settlement for securities trading carried out for each market have been unified under the JSCC.

Those who are qualified for handling clearing and settling securities transactions through the JSCC are called “clearing participants.” Clearing participants settle with the JSCC the securities transactions that have been conducted on participating exchanges. Meanwhile, securities transactions conducted by those not qualified (“non-clearing participants”) are first settled with clearing participants designated by respective non-clearing participants, which, in turn, clear such transactions with the JSCC on behalf of non-clearing participants. The main functions performed by the JSCC are (1) to assume obligations, (2) to permit the netting of securities positions and fund transfers, (3) to issue transfer instructions, and (4) to make a settlement guarantee.

Upon the execution of a transaction on a stock exchange, the JSCC assumes associated obligations (for the seller to deliver the securities sold and for the buyer to make payment for them) and, at the same time, acquires claims corresponding to both obligations. The JSCC nets long and short positions (by issue) and the proceeds and payments (of all transactions) for each clearing participant and settles the net balances. Based on this process, the JSCC helps to enhance efficiency in securities deliveries and fund payments and to streamline operations. Following netting, the JSCC instructs (“transfer instructions”) the Japan Securities Depository Center to make transfers of net securities positions and the Bank of Japan or a bank designated by the JSCC as (“the fund settlement bank”) to make a transfer of the netted amount between the accounts of the JSCC and each clearing participant. Throughout the series of netting and settlement processes, the JSCC performs and guarantees the settlement of a trade as the settlement counterparty against the trade counterparty (“settlement guarantee”). Thanks to this arrangement, parties can trade securities without being concerned about the settlement default risk of original trade counterparties.

The JSCC also performs clearing and settlement functions for OTC trading. It has expanded its scope in recent years, offering clearing and settlement services for securities traded on proprietary trading systems (PTs) in 2010. After the global financial crisis, moreover, the regulatory reform of OTC derivatives trading has proceeded in all countries, with each country being obligated to clear and settle standardized OTC derivatives trading through a central clearing house (central counterparty clearing). For its part, the JSCC

Chart X-5. Delivery and Settlement Using JSCC (Exchange Transactions)



- Notes: 1. As transactions were settled and the account transfer of securities and proceeds was carried out independently at each stock exchange, the system of delivery of securities and payment of their proceeds varied from one stock exchange to another.
 2. As of July 2010, the JSCC began assuming obligations of transactions done on PTSs.

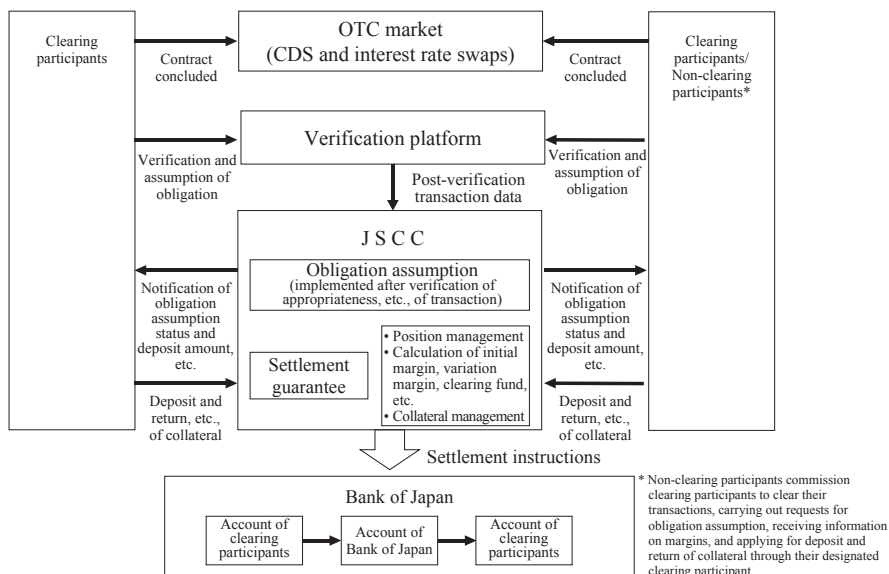
commenced clearing and settlement services for credit default swaps (CDS) transactions in 2011 and for interest rate swaps in 2012. In October 2013, the JSCC merged with the Japan Government Bond Clearing Corporation and thereby added OTC JGB transaction clearing and settlement services.

8. The Clearance and Settlement System (2)

With a view to eliminating the risk involved in the settlement of transactions in shares (and other securities handled by the Japan Securities Depository Center), in general, and the risk of a default in the payment of the principal, in particular, after the delivery of underlying securities, the JSCC has introduced a delivery-versus-payment system (DVP settlement) system.

To lessen the risk and to ensure the efficiency of settlement, the JSCC has incorporated various features into its DVP settlement system. Among other things, it has added the netting facility to its DVP settlement version. Under

Chart X-6. Delivery and Settlement Using JSCC (OTC Derivatives Transactions)



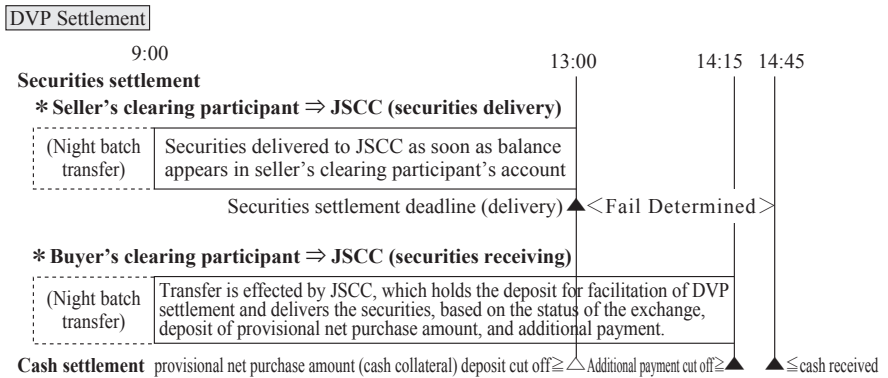
the traditional DVP settlement system, a buyer basically cannot take delivery of shares until such time as payment for them (via fund transfer) has been verified. This, however, could undermine the overall efficiency of settlement, including payment and delivery between clearing participants and non-clearing participants or customers, etc. Therefore, improvements have been made so that buyers can take delivery of the shares earlier.

More specifically, a buyer's clearing participant may take delivery of securities of a value equivalent to the following three amounts (1), (2) and (3) prior to the completion of funds settlement.

- (1) The provisional net purchase amount deposited with the JSCC as cash collateral. (Cash collateral is appropriated to the payment relating to the funds settlement when cash payment is due. The provisional net amounts will be adjusted by the amount of failed deliveries, if any, at 2:15 p.m., when cash is due from paying participants, and at 2:45 p.m., when cash is paid to receiving participants.)
- (2) The deposit for the facilitation of DVP settlement (voluntarily deposited with the JSCC).
- (3) The securities delivered to the JSCC for settlement purposes.

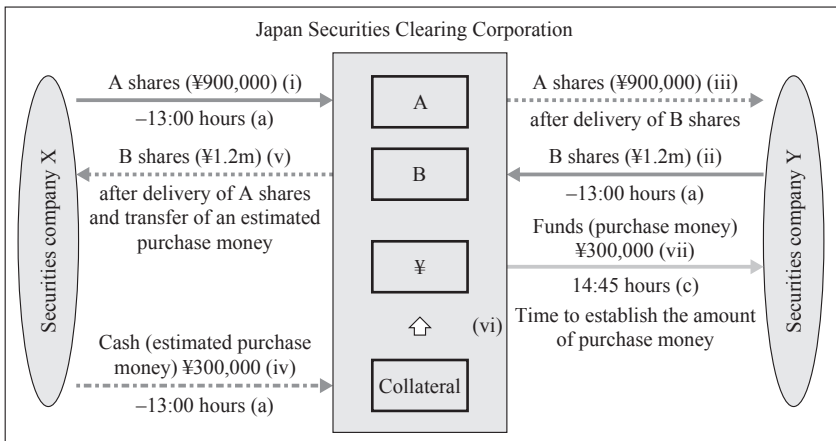
In the event that a participant should fail to deliver a security on the settlement date of a DVP trade (known as a "fail"), the JSCC will carry over the delivery of and payment for the security to the following day, when delivery

Chart X-7. DVP Settlement Timetable



Note: The receiving of securities by the buyer's clearing participant is carried out in a way that eliminates the risk of principal default versus the cash payer JSCC through nonperformance of obligations or of delivery of collateral.

Chart X-8. The DVP Scheme (normal settlement)



Deadline for settlement:

- Deadline for the delivery of securities and the deposit of the estimated purchase money (cash collateral): 13:00
 - Deadline for the payment of purchase money: 14:15
 - Time for the receipt of purchase money: 14:45
- Securities company X delivers A shares while (ii) securities company Y delivers B shares to JSCC by 13:00.
 - Securities company Y can receive A shares after delivering B shares to JSCC.
 - Securities company X deposits the estimated purchase money to JSCC by 13:00.
 - Securities company X can receive B shares after (i) and (iv) have been executed.
 - JSCC appropriates the estimated purchase money for the payment relating to funds settlement at the time the amount of the purchase money is finalized.
 - Securities company Y receives the funds (purchase money) at 14:45.

and payment are netted for settlement against the deliveries and payments for transactions of the said participant due to be settled on that day. However, as, in principle, trades are supposed to be settled on the settlement date, prolonged fails cannot be tolerated. For this reason, the DVP settlement rules also provide for penalties for damages resulting from settlement delays and the right of a buyer participant who has been assigned a failed position to buy in (or to force the failing seller to buy and deliver the required security).

9. The Book-Entry Transfer System for Stocks, Etc.

Following the computerization of stock certificates for publicly listed companies, stock certificate shares are being electronically deposited and transferred based on the collaboration of the Japan Securities Depository Center, Inc. (JASDEC), the central depository for shareholder ownership rights, and account management institutions, which are securities firms, etc., that have set up transfer accounts.

Chart X-9. Relationships Among Participants, JASDEC and Issuers in the Book-Entry Transfer System for Stocks, etc.

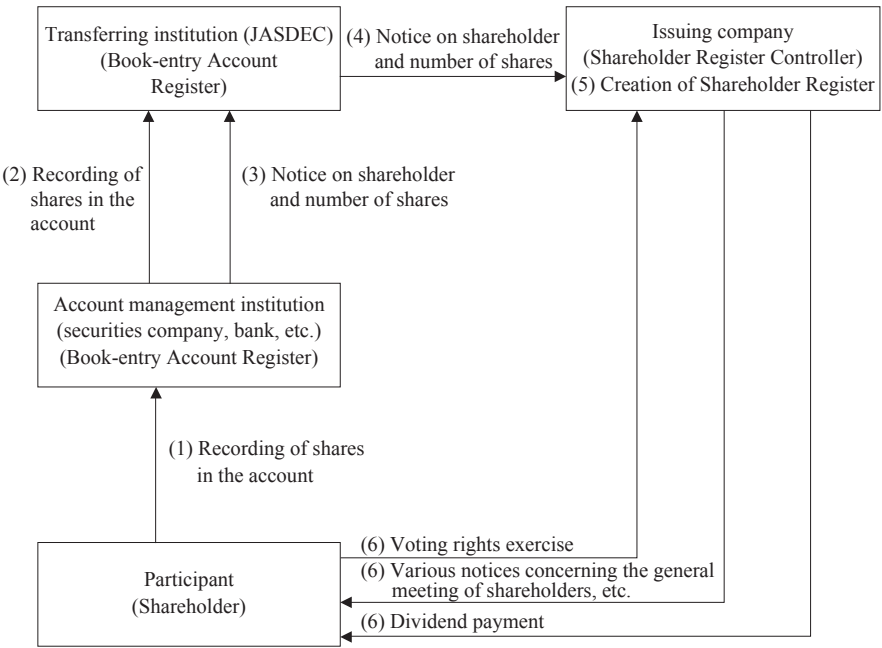


Table X-5. Major Changes in the System Before & After Implementation of Electronic Share Certificate System

	Securities Custody and Book-Entry Transfer System (prior to going paperless)	Book-Entry Transfer System (current)
Share certificates	<ul style="list-style-type: none"> • Share certificates • Stock certificates deposited with JASDEC are centrally stored at JASDEC and issued upon request • Stock certificates outside the Book-Entry System are kept individually by owners 	<ul style="list-style-type: none"> • No share certificates
Attribution of rights	<ul style="list-style-type: none"> • Presumption of rights on stock by ownership of stock certificates (outside the Book-Entry System) • Party recorded in the account register is regarded as the owner of stock certificates 	<ul style="list-style-type: none"> • Presumption of rights regarding stocks recorded in the book-entry account register
Form of shareholder management	<ul style="list-style-type: none"> • Managed by shareholder register (outside the Book-Entry System) • Managed by substantial shareholder register (within the Book-Entry System) • Name-based aggregation of shareholders is performed by the shareholder register controller 	<ul style="list-style-type: none"> • Uniformly managed by shareholder register • JASDEC performs name-based aggregation and notifies the shareholder register controller
Transfer of stocks	<ul style="list-style-type: none"> • Issuance of share certificates (outside the Book-Entry System) • Account transfer (within the Book-Entry System) 	<ul style="list-style-type: none"> • Account transfer

Securities eligible for the book-entry transfer system for stocks, etc., include stocks listed on domestic public exchanges; convertible-type corporate bonds (CB); investment units, such as real estate investment trusts (REIT); and preferred shares of cooperative financial institutions, subscription rights/warrants, beneficiary certificates of exchange-traded funds (ETFs), Japanese depositary receipts (JDR), and others.

The features and functions of the book-entry transfer system for stocks, etc., are as follows.

(1) Shareholders' ownership rights are administered based on the records of the transfer account book, with transfers of shares being processed through the transfer account. (2) Account management institutions inform JASDEC of the identification of beneficiary shareholders, including their names and addresses along with their share ownership data. JASDEC then compiles the information to periodically report to respective issuers (general shareholder notification). (3) Issuing companies produce their records of voting rights for general meetings of shareholders and retained earnings distributions based on a register of beneficiary shareholders drawn up from the general shareholder

notification. (4) Minority shareholders, etc., can exercise their rights by applying to JASDEC to have a notification sent to the issuer verifying their shareholdings, duration of ownership, and other particulars (individual shareholder notification). They can then exercise their rights for a limited period of time following receipt of the notification.

The main benefits that are expected from transition to the electronic book-entry transfer system include:

(1) shareholders can eliminate the risks of loss, theft, or forgery of certificates that are held at their own risk, and they also do not need to submit certificates to the issuer for replacement in the event of a corporate name change or change in the share trading unit; (2) issuers can save costs associated with issuance, such as printing costs and stamp duties, as well as those associated with corporate reorganization (such events as corporate mergers, stock exchanges, stock transfers) for collecting old certificates and distributing new ones; and (3) securities companies can reduce the risks and costs associated with the storage and transport of certificates.

10. Trading and Clearing Systems of the Financial Instruments Exchange (Stock Exchange) (1)

The following is a summary of the stock trading system and the settlement and clearance system that support the stock market.

On the spot market of the Tokyo Stock Exchange (TSE), the stock trading system processes stocks, corporate bonds with subscription rights/warrants, etc. (convertible bonds), and other transactions from floor trading and the off-floor ToSTNeT market. Orders from a trading participant are mainly entered through the trading partner's in-house system or through a direct connection to the TSE's trading system.

The computerization of securities trading at the TSE started with the TSE2 trading system (the old stock trading system) that went into operation in January 1982. The current stock trading platform consists of arrowhead, renewed in September 2015, and the ToSTNeT system, which was renewed in March 2017. With the basic policy of enhancing three features—reliability, convenience and processing capacity—arrowhead was renewed in order to accommodate the further development of electronic trading, a continuing increase in the number of orders, and other changes in the market environment as well as to respond better to risks that the development of electronic trading can create on the market. The ToSTNeT system was also renewed with the basic policy of expanding the processing capacity and increasing convenience.

The market information system, which had been serving the role of dis-

Chart X-10. System Integration Schedule of Japan Exchange Group, Inc.

		~FY2016	FY2017	FY2018	FY2019	FY2020~
Cash Trading System	arrowhead (Cash)	Launch 2015.9 Renewal				※
	ToSTNeT System (Off-Auction)	Launch 2017.3 Launch				※
	ISC (Index and Statistics Calculation)	Launch 2015.9 Renewal				※
Derivatives System	J-GATE (Futures/Options)	Launch 2016.7 Start of the Service 2016.9 Launch Service Launched for TOCOM				※
Clearing System	JSCC Clearing System	Function addition 2015.10 Respond to Upgrade Enhance new BOJ net correspondence	Partial RP FY2017 4Q Undecided Renew Derivatives Clearing Function Advancement of risk and collateral management functions	RP		※
	OTC Clearing System	Function addition 2017.10 Add new products		RP FY2017 4Q		※
	JGB Clearing System	Launch 2015.10 New operation		Upgrade 2018.5 Shorter Settlement Cycle		※

※Detailed schedule will be considered in the future.

Source: IT Master Plan, Japan Exchange Group, March 2017

closing marketing information, was integrated into arrowhead when arrowhead was renewed in 2015.

The Japan Exchange Group, Inc. (JPX) commenced operations in January 2013. In July 2013, it amalgamated the cash equity markets of the TSE and OSE while also integrating the stock and CB trading system of the OSE into the TSE's arrowhead and ToSTNeT systems.

The settlement and clearance system for stocks and CBs is designed to support delivery and other operations for the settlement and clearance of transactions executed on the TSE and other markets. Since January 2003, the JSCC has acted as the cross-market clearing organization for all domestic exchanges. Also in terms of the settlement and clearance system, the OSE's system was integrated into the TSE's platform in November 2014.

The data for this process from trading participants, etc., is passed through the TSE's dedicated arrownet network.

11. Trading and Clearing Systems of the Financial Instruments Exchange (Stock Exchange) (2)

The following is a summary of the trading system and the settlement and clearance system that support the derivatives market.

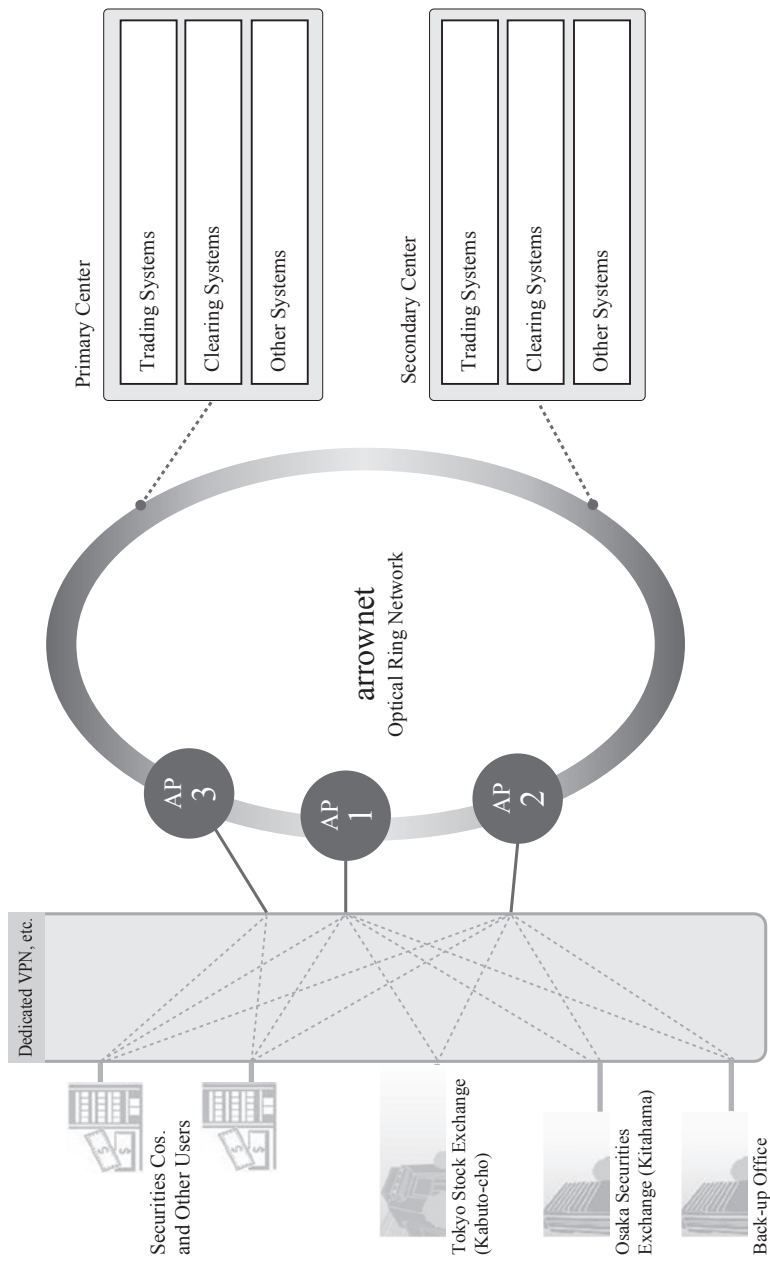
The derivatives trading system is a system for entering and matching orders, preparing transaction reports, and inquiring into the state of the order book, etc., of the derivative market of the OSE. The system processes futures, options, and other transactions from floor trading and the off-floor market. Orders from a trading participant are mainly entered through the trading partner's in-house system or through a direct connection to the TSE's trading system.

The OSE's trading system for derivatives, J-GATE, has the same functions and transaction formats used by the systems of major overseas markets. In introducing the system which began operation in February 2011, the OSE reviewed the complex transaction system peculiar to Japan to address the shift among investors to algorithmic and other advanced and diversified trading methods. In July 2016, the system was renewed with NASDAQ's Genium INET Trading at the base with a view to further increasing stability and reliability as well as promoting liquidity.

Following the launch of JPX in January 2013, the derivatives markets of the TSE and the OSE were amalgamated on the OSE market in March 2014, with the trading systems integrated into J-GATE. The J-GATE network was also consolidated into arrownet in September 2014.

Although the OSE had been using the OSE clearing system while the TSE used the JSCC clearing system, the clearing organizations were integrated

Chart X-11. Image Diagram of Japan Exchange Group's System



Source: IT Master Plan, Japan Exchange Group, March 2017

into the JSCC in July 2013 and all margin operations relating to derivatives trading have since been processed on the JSCC clearing system. Subsequently, in November 2014, clearing and settlement operations were also integrated into the JSCC clearing system. In February 2018, partial replacements were made for the settlement and clearance function for futures options transactions among others.

CHAPTER XI

Financial Instruments Exchange, etc. (2)

1. Footsteps of Emerging Markets

During the period after World War II when all stock exchanges were closed, stock trading was done on the OTC market and subsequently trading became more organized and trades were executed in group transactions. In fact, the OTC market remained active even after the country's stock exchanges were reopened, resulting in the establishment of an OTC authorization system in June 1949 to provide some control over active trading. That system was abolished in 1961 after the Tokyo Stock Exchange, Osaka Securities Exchange, and Nagoya Stock Exchange set up Second Sections that absorbed almost all authorized OTC issues. Amid Japan's high economic growth, however, there remained a need for unlisted companies to procure funding. So the Japan Securities Dealers Association (JSDA) introduced the OTC registration system (OTC Stock Market) in 1963. This was the origin of today's TSE JASDAQ market. The OTC registration system became the new OTC Stock Market in 1983 and served to complement the conventional stock exchanges, particularly as a capital market for growth and start-up companies.

In 1998, the Securities and Exchange Act was amended, and it redefined the OTC Stock Market from one to complement the conventional stock exchanges to a market that exists in parallel with other exchange markets. In 2004, the market became a securities exchange called the JASDAQ Securities Exchange, which was subsequently merged with the OSE-operated Hercules in 2010. As a result of the management integration of the TSE and the OSE, the exchange has been operated as the TSE JASDAQ market since July 2013.

In 1999, though, the Tokyo Stock Exchange (TSE) created a start-up market called Mothers. This new market strengthened investor protection through enhanced disclosure requirements, making it possible for companies with high growth prospects to list even if they had negative net worth or were not yet profitable. Consequently, start-up companies were thus able to obtain funding on the market even at their growth stage, while investors were given an opportunity to invest early in these growth companies. Subsequently,

Table XI-1. History of the JASDAQ Market

Nov. 1983	New over-the-counter (OTC) market is launched.
Dec. 1998	The Securities and Exchange Act defines the JASDAQ market as an OTC securities market (in parallel with other exchange markets).
Apr. 2002	JASDAQ selects J-Stocks and starts publishing the J-Stock Index.
Dec. 2002	JASDAQ acquires a stock exchange license and changes its name to the JASDAQ Securities Exchange.
Aug. 2007	JASDAQ establishes the NEO market.
Oct. 2007	JASDAQ, NEO, and Hercules markets merge, forming the new JASDAQ market. JASDAQ-TOP20 issues selected and publication of index begins.
July 2013	TSE and OSE combine their businesses, with the TSE continuing to operate JASDAQ

Table XI-2. History of the Mothers Market

Nov. 1999	Mothers market is launched.
Nov. 2000	Listing system for foreign companies is established. To ensure a sound market: <ul style="list-style-type: none"> • Require check prior to listing application (verification of soundness of business between a company and an underwriter). • Enhance degree of detail of inspections in listing screening (increased scope of survey of relationships with anti-social forces, etc.).
May 2002	Listing criteria reviewed: <ul style="list-style-type: none"> • Newly establish delisting criteria regarding sales. • Newly establish listing screening standards and delisting criteria regarding market capitalization. • Newly establish requirements for first public offering.
Sep. 2003	Starts publishing TSE Mothers Index.
Dec. 2006	Undertakes the first phase of a comprehensive listing system improvement program. <ul style="list-style-type: none"> • Require new applicants to obtain a letter of recommendation from the managing underwriter.
Nov. 2007	Undertakes the second phase of a comprehensive listing system improvement program. <ul style="list-style-type: none"> • Abolish provisions for moving from main exchange to Mothers market (clarify Mothers' position as a start-up market). • Abolish sales-related listing criteria. • Liberalize sales-related delisting criteria (no longer applicable after 5 years on market).
Nov. 2009	Takes steps to improve confidence in market. <ul style="list-style-type: none"> • Newly establish "appropriateness of business plan" as a listing criteria. • Newly establish stock price related delisting criteria. • Require holding of information meeting at least twice a year.
Mar. 2011	Takes steps to improve confidence in market and stimulate market. <ul style="list-style-type: none"> • Require listed companies to be audited by an audit firm registered with exchange. • Newly establish requirement to choose whether to stay on Mothers after 10 years. • Introduce listing screening policy in line with market concept (confirm appropriateness of business plan).

scandals among some of the listed companies quickly overrode the merits of the Mothers market and prompted the TSE to raise the listing requirements. Investor protection was further fortified under the Financial Instruments and Exchange Act with the introduction of quarterly financial reporting requirements and the mandatory establishment of internal control systems.

However, the discovery in 2010 of multiple cases of companies submitting false performance reports starting even before their listings, dramatically deteriorated confidence in the market once again. In addition, listings were continuing to fall after hitting the peak in 2004. Consequently, in 2011, the TSE undertook a review of the Mothers' listing system and implemented measures to increase confidence and stimulate activity in the market. Among those measures, the exchange added the requirement for listed companies to be audited by an audit firm registered in JICPA's Company Audit Firm Register. The TSE also changed its listing screening policy to one of evaluating whether the business plans of companies seeking to list were achievable in the long term.

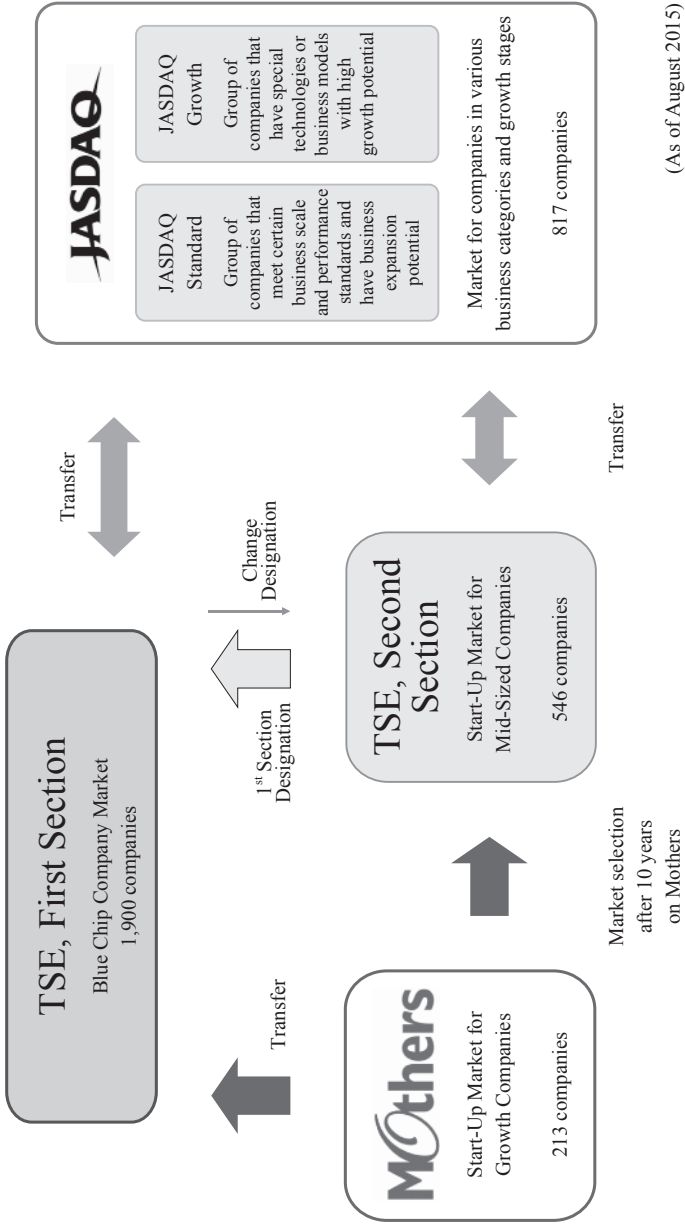
2. Start-up Market Concepts

Mothers Market Concept

In 1999, the Tokyo Stock Exchange (TSE) launched its Mothers market for start-up companies under a concept that differentiated Mothers from the TSE's First and Second Sections. The TSE established a listing system for Mothers to bring out the special characteristics of, to increase investor confidence in, and to vitalize trading on this new market. Companies wishing to list on Mothers are required to demonstrate high growth potential based on their business models, business environment, or other means. Eligibility for listing and thereby accessing the capital market is open to a broad range and number of growth companies and is not restricted by business scale or category. Among Mothers' listed companies are those with only several tens of employees and those in such infrastructure fields as information and telecommunications that boast thousands of employees.

To clarify its start-up market concept, the TSE in 2011 established a process of verifying whether corporations listed on the Mothers market matched that concept. Listed companies enjoy relatively lax listing criteria for the first 10 years, after which they are compelled to choose whether to stay on the Mothers market under more strict criteria, or move to the Second Section of the TSE. To stay on Mothers, they must have a total market capitalization of ¥4 billion or more or submit a report prepared by an independent specialist affirming the company's continued high growth potential.

Chart XI-1. Positioning of Mothers and JASDAQ Markets within the Tokyo Stock Exchange



JASDAQ Market Concept

The JASDAQ market's policy as the largest start-up market in Japan is "to support the growth of new industries and small to mid-sized start-up companies by providing them with access to equity capital and to offer attractive investment opportunities for investors." Based on this policy, JASDAQ is divided into the two sections of JASDAQ Standard and JASDAQ Growth to enable the supply of equity capital to a broad range of companies.

JASDAQ Standard is for companies of a certain business size and results that are expected to expand. JASDAQ Growth is for companies with outstanding technology or business models and ample growth potential.

Underlying the JASDAQ market are the concepts of confidence, innovation, and regional and global business. These three concepts guide JASDAQ's continuous development as the largest start-up market in Japan and as an original benchmark for start-up markets globally.

3. Start-up Market Listing Systems

Outline of Listing Criteria for Start-up Markets

The listing criteria for start-up markets are similar to those for the First and Second Sections of exchanges in that they comprise qualitative (formal requirements) and quantitative (eligibility requirements) criteria. When a stock exchange receives an application from a company wishing to list on the start-up market, it screens for eligibility based on these qualitative and quantitative criteria.

Mothers Market Listing Criteria

The Mothers market targets growth companies that have an eye on moving up to the First Section of the exchange as soon as possible. A requirement for listing, therefore, is that the company has high growth potential and a letter of recommendation to that effect from its managing underwriter.

As with the First and Second Sections, the formal requirements for listing on the Mothers market include liquidity-related standards, such as the number of shareholders and tradable shares and market capitalization; and such going concern related standards as the number of consecutive years in business, regular audits by a listed audit firm, and compliance with standards related to the disclosure of business information. Among the notable points about the requirements is that the initial public offering must be 500 trading units or more and the lack of standards regarding profits and net assets.

The eligibility requirements for the Mothers market take into account the market concept. They revolve around whether the company seeking to list is in a position to disclose its business, its risk, and other parts of its relevant

Table XI-3. Summary of Listing Criteria for the Mothers and JASDAQ Markets
(as of September 2017)

Quantitative Criteria (Formal Requirements)			
	Mothers	JASDAQ	
		Standard	Growth
Amount of net assets (Expected at listing)	—	¥200 million or more	A positive figure
Amount of profit (or total market capitaliza- tion at the time of listing)	—	<Consolidated> Profits of at least ¥100 million over the most recent year (or market capitalization of ¥5 bil- lion or more)	—
No. of shareholders ¹⁾ (Expected at listing)	300 shareholders or more		
Tradable shares ²⁾ (Expected at listing)	a through c must be satisfied. No. of tradable shares: 2,000 units or more Market value of tradable shares: ¥500 million or more Ratio of tradable shares: 25% or more of the listed stocks	Market capitalization of shares in distribution: ¥500 million or more	
Public offering or second-ary distribution	Public offering of at least 500 trading units ³⁾ by the time of listing	Public offering or secondary distribution of at least 1,000 trading units or 10% of listed shares which ever is larger by the time of listing	
Market capitalization of the shares listed (Expected at listing)	¥1 billion or more	—	
No. of years in business	Established a board of directors and have had continuous operations for more than a year counting backward from the listing application date	—	
Financial statements, etc.	The financial statements for the latest two years contain no false statements		
Auditor's opinion	“Unqualified opinion” or “qualified opinion” for the latest two years “Unqualified opinion” for the latest year		
Others	Audited by a registered listed company audit firm ⁴⁾ ; appointment of a shareholder administration agent; number of shares in <i>tangen</i> trading units; class of shares; restriction on stock transfer; ap- pointment of designated custody and transfer agent		

Notes: 1. No. of shareholders means the number of shareholders who own one or more units of shares.

2. “Tradable Shares” refer to listed shares excluding shares held by parties with a special interest such as officers, shares owned by the company itself, and shares held by persons who individually own 10% or more of listed shares.

3. One unit is the number of shares in one *tangen* trading unit when adopting the *tangen* unit shareholder system, and one share if the *tangen* unit shareholder system is not adopted.

4. An audit firm that is registered in the registry of listed company audit firms based on the Registration System for Listed Company Audit Firms of the Japanese Institute of Certified Public Accountants (including an audit firm which is sub-
ject to quality control reviews by the Japanese Institute of Certified Public Accountants).

Qualitative Criteria (Eligibility Requirements)		
Mothers	JASDAQ Standard	JASDAQ Growth
[Reasonableness of the business plan] The listing applicant has developed reasonable and suitable business plans, and has developed the operating base necessary for executing such business plans, or there is reasonable expectation that it will develop such operating base.	[Going concern] No obstacles to continuing business operations	[Company's growth potential] Has high growth potential
[Soundness of corporate management] The company is carrying out business in a fair and faithful manner.	[Reliability of corporate conduct] No suggestion that the company's conduct will disrupt the market.	
[Effectiveness of corporate governance and internal management system of an enterprise] Corporate governance and internal management system are developed in accordance with the size, corporate maturity, etc. of the enterprise, and functioning properly.	[Establishment of sound corporate governance and effective internal control] Company has established a corporate governance and internal control system in line with its size and the system functions effectively.	[Sound corporate governance in line with the growth stage and establishment of an effective internal control system] Company has established a corporate governance and internal control system in accordance with its stage of development.
[Appropriateness of the disclosure of corporate information, risk information, etc.] The company is in a state to make disclosure of the corporate information, risk information, etc. in an appropriate manner.	[Adequate corporate disclosure] The company has the organization and systems to make proper disclosure of its business conditions, etc.	
Other matters deemed necessary by the Exchange from the viewpoint of the public interest or the protection of investors.		

information and the reasonableness of its business plan and whether it has or is expected to develop the operating base necessary to execute that plan.

JASDAQ Market Listing Criteria

The new listing criteria for the JASDAQ market, just as those of the First and Second Sections, formally set out requirements on the number of shareholders, the market capitalization of tradable shares, net assets, and profits. JASDAQ also requires a ¥500 million or more market capitalization of tradable shares on the initial day of listing, but has no requirements for the number of tradable shares or the ratio of tradable shares to issued shares. JASDAQ also accommodates the special characteristics of its JASDAQ Standard and JASDAQ Growth sections by setting separate net assets and profits criteria. The eligibility requirements for JASDAQ also consider the special characteristics of each section.

They include such criteria as the lack of obstacles to continuing business operations and evidence of high growth potential. In addition, there are different net assets and profits criteria for JASDAQ Standard and JASDAQ Growth.

4. Start-up Market Listing Management Systems

The listing administration system for the start-up market operates much like the system for the First and Second Sections. Stock exchanges have established listing administration rules and conclude an agreement with listing companies regarding compliance with those rules to secure effectiveness of the rules.

Timely Disclosure, Etc. of Corporate Information

The Tokyo Stock Exchange has established rules as part of its listing regulations requiring listed companies to make timely disclosure of material corporate information.

It requires listed companies to provide timely and accurate disclosure of any material corporate information. Timely disclosure requirements are basically the same whether companies list on the First and Second Sections, on Mothers, or on JASDAQ. One difference for companies on the Mothers market is the requirement to hold an investor information meeting at least twice a year. Additionally, on the JASDAQ market, JASDAQ Growth section companies are obliged to formulate and submit a medium-term business plan to the exchange, to hold an investor information meeting about that plan, and to make the plan public.

Table XI-4. Summary of Delisting Criteria for Mothers/JASDAQ (Tokyo Stock Exchange)

(as of September 2017)

	Mothers	JASDAQ
① No. of shareholders	Less than 150 (with a grace period of one year)	
② Tradable shares	When any of a through c corresponds: a. No. of tradable shares: Less than 1,000 units (with a one-year grace period) b. Market value of tradable shares: Less than ¥250 million (with a one-year grace period) c. Ratio of tradable shares: Less than 5% of listed stocks	When either a or b occur. a. No. of tradable shares: Less than 500 units (with a one-year grace period) b. Market value of tradable shares: Less than ¥250 million (with a one-year grace period)
③ Negative net worth	If the issuer falls into negative net worth ¹⁾ (with a one-year grace period)	If the issuer falls into negative net worth ¹⁾ (with a one-year grace period)
④ Trading volume	Either the average monthly trading volume over the past one year is less than ten units or no trades were made for the past three months	—
⑤ Sales	Less than ¥100 million for the most recent one year ²⁾ .	—
⑥ Market capitalization of the shares listed	When market capitalization falls below ¥500 million and does not increase to ¥500 million or above within nine months ³⁾ .	—
⑦ Stock price	When the stock price falls below 10% of the public offering price at the time of initial listing before a period of three years lapses since listing and fails ⁴⁾ to increase its price back to 10% or more within 9 months ⁵⁾ .	When the stock price falls below ¥10 and does not recover to ¥10 or above within three months.
⑧ Performance	—	When the operating profit and the cash flow from operating activities for four consecutive fiscal years are negative and the operating profit or the cash flow does not become positive within one year.
⑨ Profits	—	(Only for Growth Section) When consolidated operating profit of a company stands negative and had been negative for nine consecutive fiscal years after the listing, and the amount of operating profit does not become positive within one year.
⑩ Bankruptcy, etc.	When an issuer becomes insolvent or falls into a situation requiring rehabilitation or reorganization proceedings, or in situations equivalent thereto ⁶⁾ .	
⑪ Suspension of business activities	When a listed issuer suspends its business activities or falls into a situation similar thereto	
⑫ Inappropriate mergers	When the stock exchange determines that a listed company that acquired another company has in effect failed to survive the merger and that the surviving company has failed to meet standards equivalent to the initial listing requirements within three years of such merger	
⑬ Deterioration in soundness of transactions with controlling shareholder	When the stock exchange determines that there has been a marked deterioration in the soundness of transactions between the company and its controlling shareholder within three years of a change in the controlling shareholder due to a third-party allotment	
⑭ Delays in securities filings	When a listed issuer fails to file an annual or quarterly securities report together with an auditor's report or quarterly review report within one month following the statutory deadline (if an extension of deadline has been approved for filing, when the listed issuers fails to file within 8 days following that deadline)	
⑮ False statements or adverse opinion	• When a false statement is made in a securities report, etc. and the competent stock exchange finds that maintaining order on the exchange could be difficult without immediate delisting of the issue • When an audit report contains an improper opinion or no auditors' opinion and the competent stock exchange finds that maintaining order on the exchange could be difficult without immediate delisting of the issue	
⑯ Securities on Alert	• When despite the issue meeting criteria to be designated as securities on alert, the competent stock exchange determines that there is no likelihood of improvement in the issuing company's internal control system, etc. • When during the process of designating the issue as securities on alert, the competent stock exchange determines that there is no likelihood of improvement in the issuing company's internal control system, etc. • When despite having designated the issue as securities on alert, the competent stock exchange determines that there is no likelihood of improvement in the issuing company's internal control system, etc.	
⑰ Breach of the listing agreement	When a listed company seriously violates the listing agreement or pledge concerning timely disclosure or when it becomes no longer a party to the listing agreement	
⑱ Undue restrictions on shareholders' rights	When shareholders' rights or exercise thereof are unduly restricted (Example) Introduction of a rights plan without contingency, introduction of a dead hand-type rights plan, issuance of a golden share (classified stock with veto power), etc.	
⑲ Others	Suspension of a listed issuer by the bank, failure to appoint a shareholder services agent, certain restrictions on share transfers, becoming a wholly owned subsidiary of another company, cancellation of the custody and transfer agent agreement, wholly call, involvement with antisocial groups, and when the competent stock exchange finds that the delisting of a given stock is in the public interest or appropriate for the protection of investors	

Notes: 1. For the Mothers market, excluding cases where an issuer records negative net worth in a period of three years after the listing. For both the Mothers and JASDAQ markets, the grace period is extended for another year if such issuer has a credible plan to wipe out the negative net worth within a year after the grace period through rehabilitation proceedings.
2. Excluding cases where the company has posted a profit and where the company's sales have been less than ¥100 million for five years following listing.
3. Three months in the case that a document indicating the current business status, future development, improvement of business plan, etc. is not submitted.
4. Limited to Mothers-listed companies listed on or after November 9, 2009.
5. Excluding a case where a reconstruction plan is disclosed and market capitalization for a period of one month is ¥500 million or above.

Code of Corporate Conduct

Start-up markets, just as the First and Second Sections of exchanges, have codes of corporate conduct in the listing rules that require listed companies to take appropriate response. The JASDAQ Growth section, however, grants listed companies a grace period in the application of some aspects of its code of conduct.

Criteria for Delisting Stocks

In the case of the Tokyo Stock Exchange, a stock may be delisted whenever it meets any of the conditions set forth in the criteria for delisting stocks in the listing regulations. Securities under supervision and securities on alert on its Mothers start-up market face the same conditions for avoiding delisting as those on the TSE's First and Second Sections.

After reviewing its Mothers listing system, the exchange has established new delisting criteria for sales and stock prices on the Mothers market. The exchange took this step to earn greater trust among Mothers' investors, to enhance the appeal of the Mothers market, and to prevent any sudden changes in the quality of the management of a corporation following its listing on the Mothers market.

Similarly, the JASDAQ market's delisting criteria are also designed to maintain or improve the overall quality of its issuers. Newly established criteria include business performance standards to ensure investor confidence in the market without neglecting listed companies whose business models have collapsed and stock price standards that eliminate issues with stock prices that have languished at low levels for a certain period of time. Following, moreover, the separation of issuers into the JASDAQ Standard and JASDAQ Growth sections, the exchange revised its delisting criteria in line with the special characteristics of each section.

5. An Outline of the OTC Stock Market

(1) What is OTC trading?

In addition to shares traded on stock exchanges, shares are also traded over the counter. As only those listed issues that meet certain listing standards may be traded on exchanges, issues that are not eligible for exchange trading need to be traded elsewhere, outside listed exchanges. Such shares are traded between securities companies serving as brokers/dealers or between customers and brokers/dealers over the counter in negotiated transactions known as "over-the-counter (OTC) transactions." While trading and other activities involving listed shares are regulated by the competent stock exchange, OTC stock trading executed through securities companies is regulated by the

Table XI-5. A Brief History of the OTC Market

1945	Group trading in shares emerges spontaneously after the war.
1949	A system of trading in OTC-authorized issues is launched in June under the rules of the JSDA.
1961	The stock exchanges create the Second Section, into which OTC-authorized issues are absorbed, and the OTC authorizing system is terminated.
1963	The OTC registration system is launched in February.
1976	The OTC market broker, Japan OTC Securities, Inc., is established.
1983	A new OTC Stock Market (the JASDAQ market) is launched in November.
1991	The JASDAQ system comes into operation.
1992	The Prohibited Acts Rule is applied to the JASDAQ market.
1997	The green sheet system is launched.
1998	The JASDAQ market becomes the OTC securities market for the purpose of the Securities and Exchange Act (currently, the Financial Instruments and Exchange Act).
2001	Japan OTC Securities changes its name to JASDAQ, Inc., and takes charge of the market.
2004	The JASDAQ market becomes a securities exchange in December and the OTC securities market is closed.
2005	Green sheet issues become “to-be-handled securities” for the purpose of the Securities and Exchange Act in April, and the regulations of insider trading are applied to green sheet issues.
2008	The Phoenix issue system is spun off from the green sheet system into an independent system.
2015	Equity Crowdfunding Scheme and Shareholders Community System are established in May.
2018	The Green Sheet system is scheduled to be abolished in March.

“Rules Concerning Over-the-Counter Securities” of the Japan Securities Dealers Association (JSDA) and by other rules.

OTC transactions include transactions in unlisted shares (including unlisted shares issued by listed companies); transactions effected in the OTC securities market; and off-exchange transactions in exchange-listed shares.

(2) An Outline of the OTC Stock Market

As OTC trading becomes active, information about quotes and prices is exchanged among securities companies and distributed to investors, and the market becomes more organized. After the war, OTC trading remained active even after the reopening of stock exchanges. In 1961, actively traded OTC issues were moved to the Second Section of the stock exchanges, but stocks continued to be actively traded over the counter to such an extent, in fact, that an OTC stock market, an organized market where OTC securities that meet the registration requirements of the JSDA are traded, was launched in February 1963.

As solicitation for investments was restricted in the early years, the OTC

stock market was generally characterized as a market for the liquidation of stock holdings. To remedy the situation, the legal framework was enhanced by the 1971 amendment to the Securities and Exchange Act, and, in 1983, the OTC stock market was defined as a market that complements exchange markets and was reorganized drastically into the JASDAQ market for trading shares of mid-tier small-to-medium sized enterprises with reasonable track records. The JASDAQ market has since grown larger as a market for emerging companies, and it was redefined as an “OTC securities market” under the Securities and Exchange Act in 1998. But the designation of “OTC securities market” exists only in law following the upgrading of the JASDAQ market into the JASDAQ Securities Exchange in December 2004.

Because a need arose for trading unregistered or unlisted stocks also outside the JASDAQ market, the JSDA established the green sheet system in July 1997 and in May 2015 created a system for equity crowdfunding in addition to the shareholders community system that replaced the green sheet system, thereby enabling sales solicitations for such issues. Another category of traded unregistered or unlisted stocks is the *Aozora* issues or private equity issues.

6. OTC Securities, Etc.

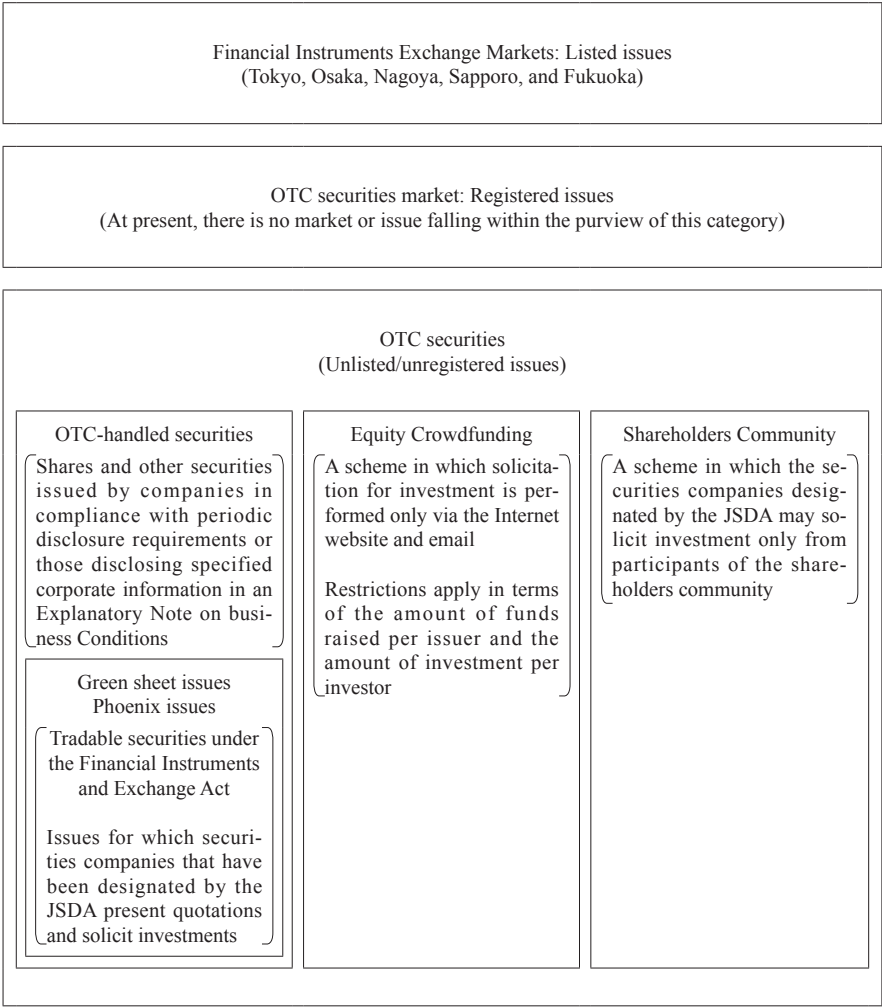
(1) Unlisted/unregistered Issues (*Aozora* Issues)

Issuers of unlisted or unregistered stocks are not required by law to disclose their corporate information, and, in principle, JSDA rules prohibit securities companies from soliciting investment in such issues. This is because soliciting the investing public, including individual investors, for an order to buy or sell a security on which no pertinent corporate information is available would subject the public to significant risks and cause various problems from the standpoint of the protection of investors, and such self-regulatory rules have been in place for a long time.

However, brokers/dealers may accept unsolicited orders for such issues and trade them with customers as so-called *Aozora* issues (OTC securities) in negotiated transactions. The rules pertaining to such transactions (including those prohibiting them from accepting market orders or affecting when-issued or margin trading) are contained in the Rules Concerning Over-the-Counter Securities of the JSDA.

The April 2004 amendment to the Securities and Exchange Act authorized a company to issue an equity product in private placements limited to qualified institutional investors. Under this amendment, securities companies are allowed to solicit only Qualified Institutional Investors for the purchase of such shares on the condition that they do not resell their holdings to anyone

Chart XI-2. Relationships Between OTC Securities and Listed/Registered Issues



other than Qualified Institutional Investors.

(2) OTC-handled Securities

Securities whose issuers regularly disclose specified corporate information in the form of an Explanatory Note on Business Conditions are considered to carry less risk than other unregistered issues. And the rules of the JSDA define them as “over-the-counter-handled securities,” or OTC securities eligible

for solicitation by promoting brokers/dealers.

An Explanatory Note on Business Conditions is a type of disclosure material required by the JSDA and prepared in accordance with the format for the “corporate information” section of a securities report pursuant to the Financial Instruments and Exchange Act. It shall be accompanied by annual financial statements with an audit report that includes the opinion of certified public accountants or persons with equivalent designation that the company’s financial statements are unqualified or qualified in light of the provisions of the Financial Instruments and Exchange Act or in conformity with those of the Companies Act. Such explanatory note shall also contain forward-looking statements as to the outline of the company’s business plan, its feasibility, and other aspects. In the case of a company in compliance with periodic disclosure requirements, a securities report or a securities registration statement with an unqualified or qualified opinion of the auditor can be substituted for the Explanatory Note on Business Conditions.

At present, the ban on solicitation for the purchase of OTC-handled securities is partially lifted for primary or secondary offerings of securities on the condition that the transfer of such shares is restricted for two years based on an agreement among the issuer, securities companies, and investors and that the issuer publishes an Explanatory Note on Business Conditions. The ban is fully lifted for unlisted securities of listed companies based on the condition that the issuer publishes an Explanatory Document on Securities Information, etc.

7. Equity Crowdfunding (1)

(1) What is Equity Crowdfunding?

The term “crowdfunding” is a coined word composed of “crowd” and raising funds or “funding.” It refers to the practice of funding start-ups and growth companies by asking a large number of people to each contribute a small amount of money, often performed via Internet-mediated registries.

With the use of the Internet, crowdfunding makes it possible to raise funds, even on a small scale, at low cost and over a wide range by collecting a small amount of money from a large number of contributors. Thus crowdfunding, primarily the purchase-type and lending-type, has rapidly become a popular option for raising capital in the last few years. Given the circumstances, an equity crowdfunding system was also introduced in May 2015 with a view to promoting provision of risk money to start-ups and growth companies and enabling such companies to raise funds by issuing OTC securities.

The equity crowdfunding scheme may be used only by securities companies and intermediaries specializing in small-amount equity crowdfunding

Chart XI-3. Concept Diagram of Equity Crowdfunding

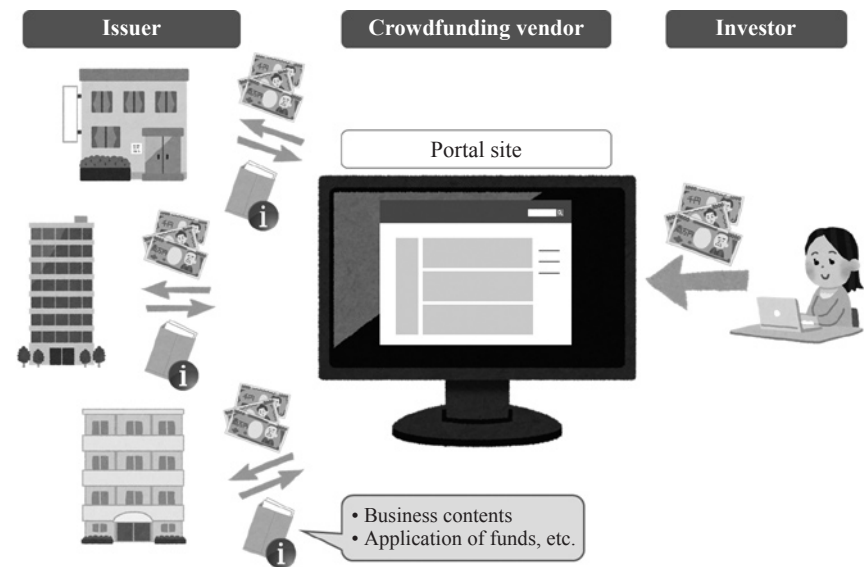


Table XI-6. JSDA’s Self-Regulatory Rules
Key components of the Rules Concerning Equity Crowdfunding Operations

- | |
|---|
| <ol style="list-style-type: none">1 . Solicitation for investments conducted by members of the JSDA (securities companies and Type I Small Amount Electronic Subscription Handling Agents) under the equity crowdfunding scheme is permitted as an exception to the prohibition of investment solicitation relating to unlisted stocks.2 . Examination of issuers and measures to eliminate antisocial forces3 . Indication of equity crowdfunding deals on the website4 . Issuance of document prior to conclusion of contract5 . Request for letter of intent from investors purchasing unlisted stocks for the first time under the equity crowdfunding scheme6 . Small-amount requirements (total amount of funds raised per issuer: less than ¥100 million a year; investment per investor for one issuer: no more than ¥500,000 a year)7 . Prohibition of simultaneous use of solicitation method other than the Internet (e.g., telephone and face-to-face contact)8 . Conclusion of an agreement to the effect that the issuer provides proper information on a periodical basis to investors after the completion of handling of investment under the equity crowdfunding, and confirmation of information provision9 . Establishment of an operation management system10. Reporting and publication of monthly results |
|---|

(Type I Small-Amount Electronic Public Offering Service Operators) that are registered as Type I Financial Instruments Business Operators.

(2) Small Amount Requirements and Prohibition of Concurrent Use of Unspecified Solicitation Methods

In light of the nature of the equity crowdfunding scheme of raising a small amount of funds from each of a large number of investors, certain restrictions apply in the equity crowdfunding system. The amount of funds raised per issuer must be less than ¥100 million per year and the amount of funds contributed per investor to an issuer must not exceed ¥500,000 per year. In addition, considering that investment frauds involving unlisted stocks and corporate bonds continue to take place, the method of solicitation for investment is limited to using (i) the website and (ii) email assuming the use of the aforesaid website, and solicitation by telephone and visits by securities companies, etc. are prohibited.

(3) Examination of Issues and Issuers

In handling OTC securities using the equity crowdfunding scheme, securities companies, etc. may carefully examine each issuer and verify the nature of their business, financial standing, appropriateness of business plan, intended use of funds, etc. in accordance with their internal rules and may handle only such issuers they recognize to be proper. Securities companies, etc. also enter into a contract with each issuer to the effect that the issuer is not an antisocial force, and must not use an equity crowdfunding scheme if it is recognized that an issuer corresponds to an antisocial force.

8. Equity Crowdfunding (2)

(4) Provision of Information via Website and Receipt/Delivery of Documents

While using the equity crowdfunding system, securities companies, etc. must provide information on issuers and fund raising as well as on risks, etc. specific to the acquisition of OTC securities issued by the issuers (such as no obligation to provide disclosure comparable to that prescribed by the Financial Instruments and Exchange Act or to the timely disclosure required by stock exchanges) via the website for inspection by investors.

Furthermore, in order to receive confirmation from investors purchasing OTC securities for the first time under the equity crowdfunding scheme of their understanding of risks, commission, etc. involved and of making the investment based on their judgment and responsibility, securities companies, etc. must provide advance explanations of these matters, request a letter of

Chart XI-4. Provision of information to investors and receipt/delivery of documents in equity crowdfunding

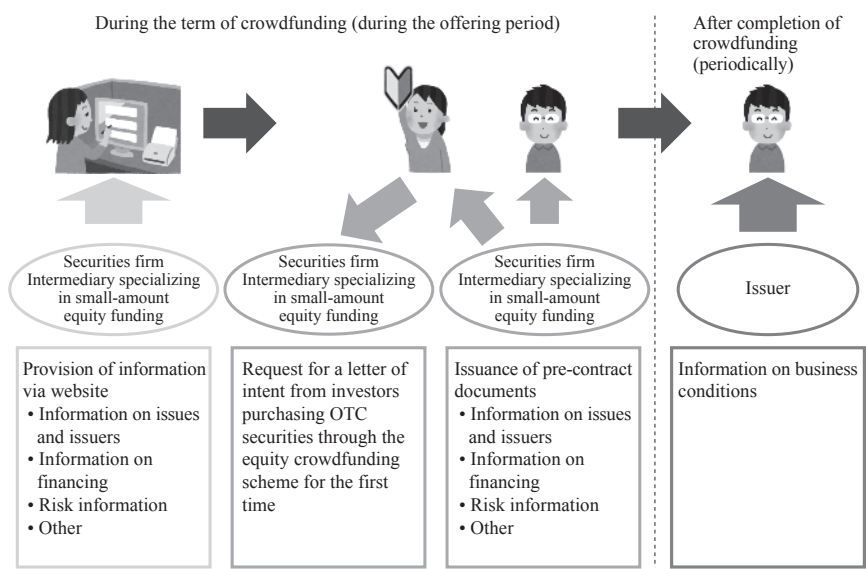


Table XI-7. Handling of Equity Crowdfunding

As of January 31, 2018

	Number of registered firms (companies)	Number of deals handled (deals)	Amount of financing (¥1,000)
2015	—	—	—
2016	—	—	—
2017	3	18	514,740
2018	3	4	121,880

intent from each investor, and deliver the document prior to conclusion of contract containing at minimum the matters to be informed via the website concerning individual issues for every investment handled.

(5) Periodical Subsequent Information Offering by Issuer

After completing the handling of investment under the equity crowdfunding scheme, securities companies, etc. must enter into an agreement with each respective issuer with regard to the proper offering of information on a periodic basis by the funds-raising issuer to the investors who purchased the

OTC securities and must ensure that the issuer provides such information in accordance with the agreement.

(6) Reporting and Announcement of Investment Status

Securities companies, etc. must report the status of investments made under the equity crowdfunding scheme on a monthly basis to the JSDA, and the JSDA publishes the information reported.

(7) Establishment of an Operation Management System, Etc.

Securities companies, etc. must formulate internal rules and put in place an operation management system necessary for properly carrying out equity crowdfunding while complying with laws and regulations and their self-regulatory rules. In addition, securities companies, etc. are required to prepare an outline of their equity crowdfunding procedure and publish it on the company's website to enable investors to view the information.

When a securities company or such party is requested to make improvements, etc. to its operation management system due to a violation of law or its self-regulatory rule or for other reasons, the securities company or such party must not be engaged in equity crowdfunding until the requested improvements, etc. are completed.

9. Shareholders Community (1)

(1) What is Shareholders Community?

The JSDA has been operating the green sheet system, a mechanism for promoting the smooth circulation of unlisted securities. However, the use of the system has become stagnant, due to the weakening significance of the system as a function to complement stock exchanges as listing criteria for emerging markets becoming lax and to the disclosure burden imposed, which is comparable to that of listed companies (Corporate Information Memorandum similar to those required by the Financial Instruments and Exchange Act and the timely disclosure obligation associated with the application of insider trading regulations). Meanwhile, needs for trading and conversion of unlisted stocks of locally operating firms, etc. continued to exist at a certain level, and there were calls for a system to accommodate these needs.

Under these circumstances, the Shareholders Community System was introduced in May 2015 as a system for unlisted stock trading and fund-raising to replace the green sheet system.

With a view to restricting distribution, Shareholders Community was established as a mechanism in which a securities company creates a shareholders community by OTC issue and accepts investments only from investors

Chart XI-5. Basic Mechanism of Shareholders Community

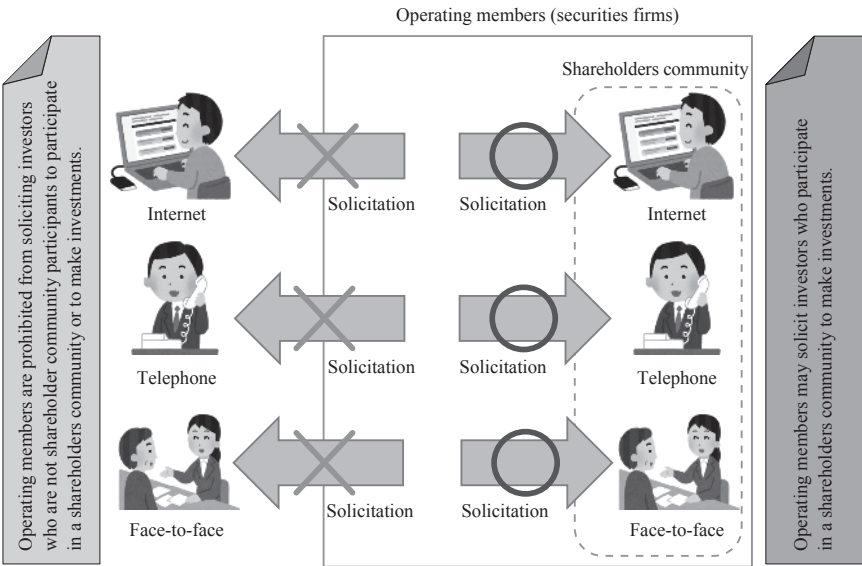


Table XI-8. Major Components of the JSDA’s Self-Regulatory Rules regarding Shareholders Community

1. Securities companies construct a shareholders community for an unlisted stock. Investors intending to invest in the unlisted stock participate in the shareholders community.
 - Assumed principal participants include officers and employees and their families of the issuer; shareholders and business partners of the issuer; and users and customers of the issuer’s business.
2. Securities companies structuring and operating a shareholders community receive designation by the JSDA as operating members.
3. Solicitation for investment is allowed only toward investors who participate in a shareholders community.
 - No solicitation for investment to investors who are not participants.
 - No solicitation for participation to investors who are not participants.
 - Investors not participating in a shareholders community are provided with only the basic information concerning the shareholders community issue.
4. Examination of issuers and measures to eliminate antisocial forces
5. Investors participating in a shareholders community are provided with financial statements, business reports and other information based on the Companies Act in regard to the issuer.
6. Issuance of document prior to conclusion of contract
7. Investors who participate in a shareholders community for the first time are requested to submit a letter of intent.
8. Establishment of an operation management system
9. Weekly reporting and public disclosure of trades
10. The Green Sheet system will be abolished as of March 31, 2018.

that proactively declare and participate in the community. Since distribution of unlisted issues is restricted under the Shareholders Community System because the scope of solicitation and trading is limited to participants of the shareholders community, the System is not subject to the application of insider trading regulations.

(2) Designation and Cancellation of Designation of Operating Members

In order for a securities company to create and operate a shareholders community, it must register with the JSDA and receive designation as an operating member. The JSDA designates and announces a securities company as an operating member if it finds no fault in the registration documents, but may decide not to grant designation if the securities company is found to be in violation of law or self-regulatory rules.

Cancellation of designation as an operating member is normally based on a notification submitted by the operating member. It may cancel the designation altogether or suspend the designation for a certain period of time even without the aforesaid notification if, however, the JSDA finds that an operating member is in violation of law or self-regulatory rules, etc.

(3) Prohibition of Solicitation for Participation in a Shareholders Community and of Solicitation for Investment

Participation in a shareholders community is based on an investor's proactive declaration. Therefore, operating members may not solicit investors who are not shareholders community participants to participate in a shareholders community or to make investments.

OTC trading of shareholders community issues must be executed between participants of a shareholders community operated by an operating member or between a participant and the operating member.

10. Shareholders Community (2)

(4) Examination of Issues and Issuers

In handling OTC securities for which a shareholders community is to be created, operating members may strictly examine each issuer and verify the nature of their business, financial standing, etc. in accordance with their internal rules and may handle only such issuers they recognize to be proper. Operating members also enter into a contract with each issuer to the effect that the issuer is not an antisocial force, and must dissolve the shareholders community if it is recognized that an issuer corresponds to an antisocial force.

Chart XI-6. Receipt/delivery of documents regarding shareholders community issues

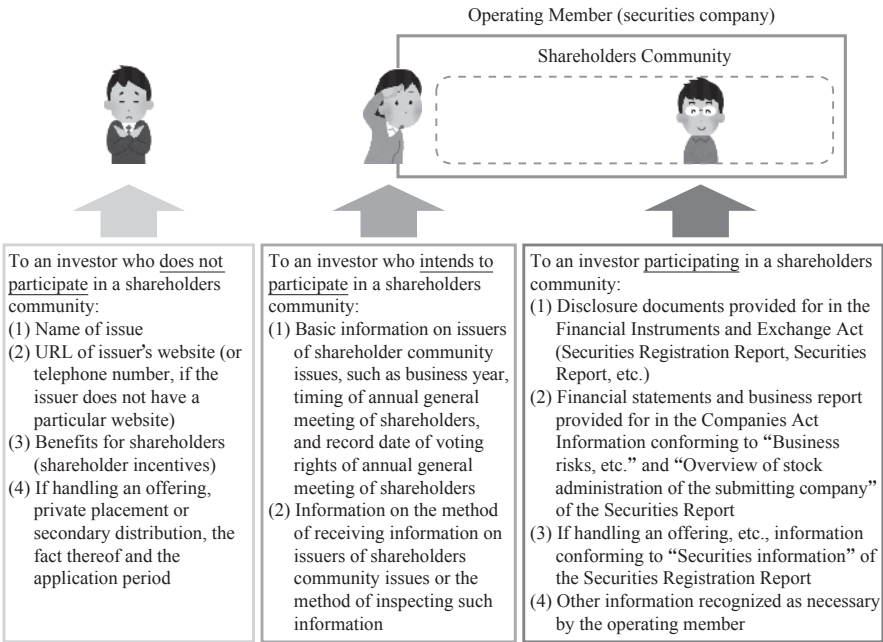


Chart XI-7. Provision of information regarding shareholders community issues

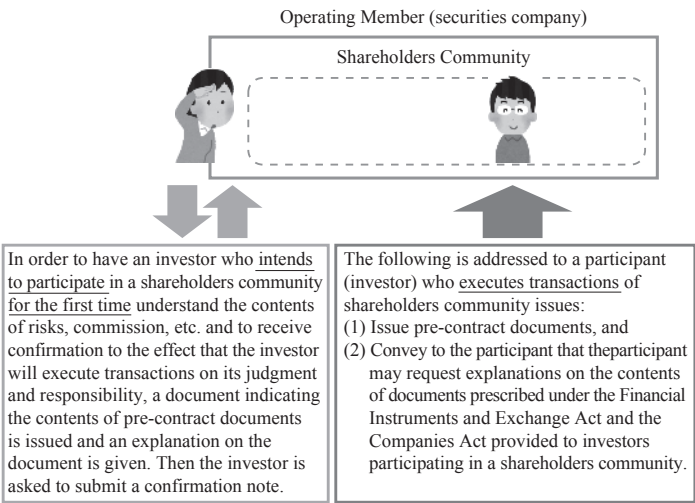


Table XI-9. Handling of Shareholders Community

As of January 31, 2018

	Number of operating members (companies)	Number of portfolio issues (issues)	Trading amount (¥1,000)
2015	2	11	71,149
2016	3	13	441,599
2017	3	16	551,013
2018	4	17	5,056

(5) Provision of Information Regarding Shareholders Community Issues and Receipt/Delivery of Documents

Operating members are to provide investors with the necessary information on shareholders community issues depending on the magnitude of involvement (participation or declaration of participation in the shareholders community, or not) by each investor with the shareholders community.

Furthermore, in order to receive confirmation from investors executing OTC transactions of shareholders community issues for the first time on their understanding of risks, commission, etc. involved and of making the investment based on their judgment and responsibility, operating members must provide advance explanations of these matters, request a letter of intent from each investor, and deliver the document prior to conclusion of contract containing at minimum the risks specific to such OTC transactions and other matters (e.g., no disclosure obligation comparable to the disclosure prescribed in the Financial Instruments and Exchange Act or to the timely disclosure required by stock exchanges is imposed) concerning individual issues, and explain the contents thereof.

(6) Withdrawal from and Dissolution of Shareholders Community

Operating members shall perform the withdrawal procedure when notified by a participant of the shareholders community of the participant's intent to withdraw or when there are other reasons as prescribed in the handling guide. If an operating member's designation is cancelled by the JSDA, the operating member must immediately dissolve all shareholders communities it operates.

(7) Reporting and Announcement of Investment Status

Operating members must report the status of OTC trading of shareholders community issues they handle on a weekly basis to the JSDA, and the JSDA must publish the information reported.

(8) Establishment of an Operation Management System

Operating members and securities companies intending to become operating members must formulate internal regulations and put in place an operation management system necessary for properly operating shareholders communities. In addition, operating members are required to prepare an outline of their shareholders community operating method, etc. and publish the outline.

11. The Green Sheet and Phoenix Issue Systems (1)

(1) Outline of the Green Sheet System

Even after the listing standards of exchanges had been eased to allow some of the loss-making companies to go public, it was deemed necessary to improve the market for issuing and trading unlisted shares in order to improve the financing environment for venture businesses. Aware of this, the Japan Securities Dealers Association (JSDA) partially eased its rules concerning OTC securities in July 1997 to allow its member brokers to solicit customers for investment in securities, including OTC-handled securities, filing an Explanatory Note on Business Conditions so that brokers may market such securities at times, provided that the brokers continuously publish quotes and other relevant market information for the securities. This trading framework is called the green sheet system. Subsequently, based on the amendment to

Chart XI-8. Green Sheet Statistics

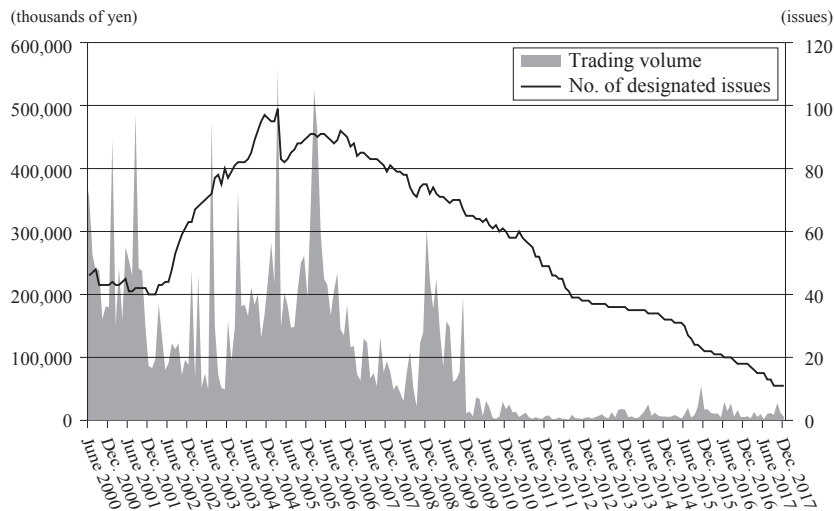


Chart XI-9. Flow of Investment Solicitation for Green Sheet and Phoenix Issues

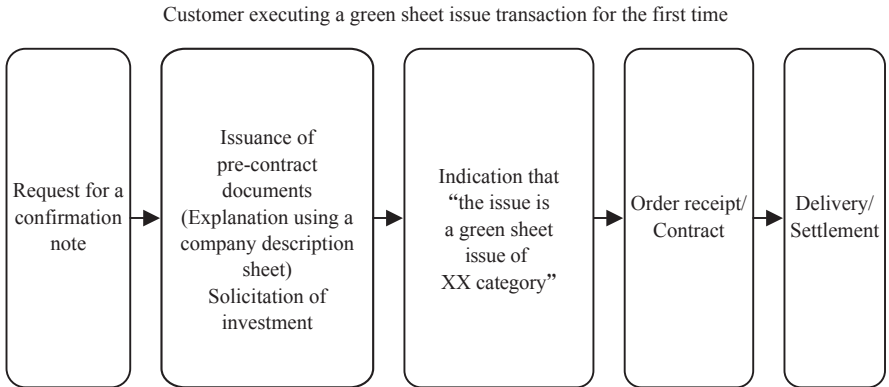
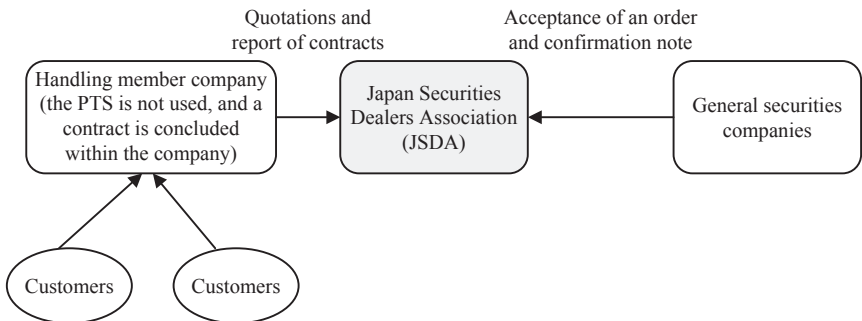


Chart XI-10. Outline of Trading in Green Sheet and Phoenix Issues and Trade Reports



the Securities and Exchange Act in April 2005, insider trading rules were also applied to green sheet issues and the issuers of green sheet issues were required to provide timely disclosure using the TDnet.

In conjunction with the establishment of the shareholders community system, a new trading system for unlisted stocks, the green sheet system will be abolished at the end of March 2018.

(2) Phoenix Issue System

The Phoenix issue system is an OTC trading system launched by the JSDA on March 31, 2008, to provide a marketplace for issues that had been delisted from stock exchanges. Phoenix issues started off as a category in the green sheet system. In response to the successive delisting of large-cap issues, such

as Seibu Railway, Kanebo, and Livedoor, however, the JSDA established the system for Phoenix issues to improve investors' opportunities to cash out of delisted issues and to provide the necessary framework for delisted companies to have a second chance at re-listing.

The Phoenix issue system differs substantially from the green sheet system in that it utilizes the book-entry transfer system for stocks, etc. to give investors an opportunity to cash out their holdings through the stock exchange even after the decision to delist the stock whereas the receipt, delivery, and settlement of green sheet issues are conducted using the stock certificates.

(3) Designation of Issues

When a securities company chooses to handle a particular delisted share as a Phoenix issue, it must submit a notification to the JSDA after verifying that the accompanying audit report contains an opinion from the auditor and that the issue meets certain conditions with regard to the consignment of share administration, etc. The JSDA checks the contents of the notification and then provides the designation as a Phoenix issue and handling member.

Since the green sheet system is scheduled to be abolished as previously mentioned, new designation of issues and handling members is no longer be made.

12. The Green Sheet and Phoenix Issue Systems (2)

(4) Timely Disclosure

Issuers of green sheet and Phoenix issues are obligated to carry out timely disclosure to the extent comparable to that of listed companies, including the disclosure of quarterly reports, via the TDnet. In addition, handling members are expected to take responsibility in guiding issuing companies regarding disclosure.

(5) Investment Solicitation and Trading

A broker must obtain from the customer who conducts a transaction in green sheet or Phoenix issues for the first time a letter confirming that he or she will invest with a full understanding of the green sheet system and the risks associated with green sheet issues. In addition, in soliciting customers for investment in a green sheet security, a broker must give a full and fair explanation of the issue and issuer using the Explanatory Note on Business Conditions as well as deliver the Document Prior to Conclusion of Contract provided for under Article 37, Paragraph 3 of the Financial Instruments and Exchange Act and provide explanation on the contents of the document.

Trading hours run from 9:00 a.m. to 3:00 p.m. on business days. Handling

Table XI-10. Comparison of the Green Sheet and Phoenix Issue Systems

	Green sheet system	Phoenix issue system
Eligible securities	Stocks, share option certificates, corporate bonds with subscription rights/warrants, preferred notes, investment securities, and investment equity subscription right certificates	Stocks and corporate bonds with subscription rights/warrants attached that have been delisted
Designation required	Yes	Sames as left
Obligation for handling member to review issue	Yes	No
Criteria for losing designation	Yes	Sames as left
Investment solicitation	Only handling members and associate handling members	With the exception of investors selling on their own volition, only handling members and associate handling members
Confirmation	Yes	Yes (unnecessary for sales)
Trading process	Negotiated transaction	Sames as left
Delivery and settlement	Direct delivery and settlement (in principle, 4 business days or T+3)	Directly through JASDEC's transfer system (in principle, T+3)
Trading hours	9:00~15:00	Sames as left
Reporting and disclosure obligations for quotes and orders	Yes	Sames as left
Disclosure materials	Explanatory Note on Business Conditions and securities report (Financial statements for the two previous terms must be accompanied by an auditor's opinion stating fair representation)	Sames as left (Financial statements with only an auditor's opinion stating fair representation for the previous term are acceptable)
Timely disclosure	Disclosure items specified by the JSDA	Sames as left
Insider trading rules	Applied	Sames as left

members may make investment solicitation and accept orders at any time. Those registered as associate handling members may also make investment solicitation and accept orders, and other securities companies are also allowed to trade within the scope of the system.

Transactions shall be settled and the securities traded shall be delivered, in principle, on the fourth business day counting from and including the trade date (T+3 settlement). While green sheet issues are settled in share certificates, Phoenix issues are settled through the Book-Entry Transfer System for Stocks, etc.

In addition to the application of insider trading regulations as mentioned earlier, trading rules ban member brokers/dealers from accepting market orders; effecting margin trading or when-issued transactions with customers; prearranging trades with other brokers/dealers; or engaging in excessive trading, kiting, bear-raiding, or other improper trading practices. Furthermore, the JSDA, as part of its trading management function, suspends and inspects trading.

(6) Reporting and Disclosure of Quotes and Contract Information

Handling members and associate handling members shall, as a general rule, report quotes and trading information every business day. Securities companies that have accepted orders from, or have entered into transactions with, their customers must report such orders or transactions to the JSDA, and the JSDA, in turn, compiles the data received and publishes such information.

(7) Revocation of Designation of Issues

The designation as a green sheet issue or a Phoenix issue is revoked when there is no longer a sponsoring handling member. In addition, the JSDA may revoke the designation upon certain events occurring to the issue or its issuer, including listing on stock exchanges, the commencement of bankruptcy proceedings, and false statements in disclosure documents.

13. TOKYO PRO Market

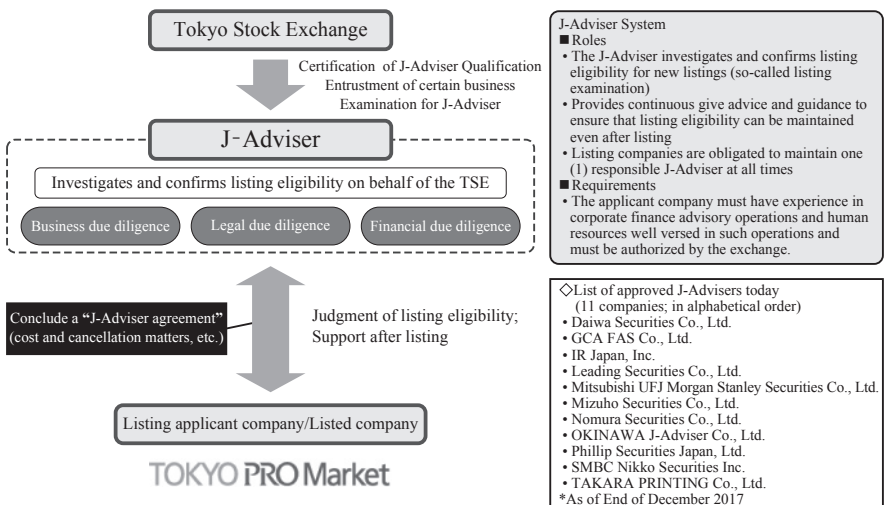
The TOKYO PRO Market is a market for professional investors operated jointly by the Tokyo Stock Exchange (TSE) and the London Stock Exchange (LSE). It is based on the TOKYO AIM market launched by the TSE in June 2009. TOKYO AIM, Inc., was originally operated as a partnership (ownership: TSE 51%; LSE, 49%). In March 2012, however, the TSE acquired LSE's stake and merged Tokyo AIM with the TSE in July 2012. TOKYO AIM is operated under the professional investor market system provided for by the enactment of the December 2008 revision of the Financial Instruments and Exchange Act (FIEA).

Placing orders on traditional exchanges is not limited to any special category of investor. The professional investor market system, conversely, restricts trading to specified investors and nonresidents. Where fund procurement is limited to professional investors, securities registration statements are not required, and issuers need only make public financial information, etc. (called specified securities information), using the format and method stipulated by the TSE. Companies already listed on the exchange, moreover, need not submit annual securities reports and need only make public financial in-

Table XI-11. Overview of TOKYO PRO Market Listing System

Disclosure language	• Japanese or English						
Listing criteria	• No quantitative criteria						
Subject of evaluation	• J-Adviser (Conducts review and check on listing eligibility on behalf of the exchange)						
Period from listing application to listing approval	• As a general rule, ten (10) business days • (provided, however, that there is a check procedure by the exchange to J-Adviser 30 business days prior to application)						
Audit certification	Latest one (1) year						
Internal control report	Optional						
Quarterly disclosure	Optional						
Investors	<ul style="list-style-type: none"> • Professional investors (Note) and non-residents <i>Note:</i> Professional investor refers to: <table border="1"> <tr> <td>Specified investors (<i>Tokutei Toushika</i>)</td><td>Qualified Institutional Investors (e.g., financial institutions); National government; Bank of Japan</td></tr> <tr> <td>Specified investors (<i>Tokutei Toushika</i>) (may shift to general investors)</td><td>Listed companies and corporations with paid-in-capital of no less than ¥500 million</td></tr> <tr> <td>“Deemed” specified investors</td><td>Corporations other than specified investors Individuals with financial assets and net assets worth no less than ¥300 million and with the experience of dealing with financial instruments for one (1) year or more</td></tr> </table> 	Specified investors (<i>Tokutei Toushika</i>)	Qualified Institutional Investors (e.g., financial institutions); National government; Bank of Japan	Specified investors (<i>Tokutei Toushika</i>) (may shift to general investors)	Listed companies and corporations with paid-in-capital of no less than ¥500 million	“Deemed” specified investors	Corporations other than specified investors Individuals with financial assets and net assets worth no less than ¥300 million and with the experience of dealing with financial instruments for one (1) year or more
Specified investors (<i>Tokutei Toushika</i>)	Qualified Institutional Investors (e.g., financial institutions); National government; Bank of Japan						
Specified investors (<i>Tokutei Toushika</i>) (may shift to general investors)	Listed companies and corporations with paid-in-capital of no less than ¥500 million						
“Deemed” specified investors	Corporations other than specified investors Individuals with financial assets and net assets worth no less than ¥300 million and with the experience of dealing with financial instruments for one (1) year or more						

Chart XI-11. Role of J-Adviser



formation, etc. (issuer information), using the TSE-stipulated format and method. The submission of internal control system reports and quarterly disclosure are voluntary. By premising requirements on the fact that only professional investors—those capable of analysis and making investment decisions—will invest in the market, the cost burden of issuing has been reduced in comparison with traditional stock exchanges.

The statutory penalties for falsifying financial information, etc., and for insider trading apply as much to the professional investor market system on the report of possession of large volume and tender offer systems. The page on the right shows details of how the TOKYO PRO Market aims to provide a flexible but disciplined market system for issuers and investors through the J-Adviser system (approved adviser system) within the previously mentioned legal framework. This operational method, which has the J-Adviser system at its core, has been drawn substantially from the Nomad (Nominated Adviser) system of the LSE's Alternative Investment Market (AIM). Under the system, specialists in corporate finance, etc., who have been approved as J-Advisers are required to guide a company through the admission process and to fulfill a duty to provide advice and instruction on timely disclosure and other regulatory matters following listing.

As of December 31, 2017, the TOKYO PRO Market had 11 J-Advisers and 22 listed companies.

CHAPTER XII

Financial Instruments Business (Securities Business)

1. Overview of Financial Instruments Business Operators (Securities Companies) (1)

While the Financial Instruments and Exchange Act (FIEA), a comprehensive overhaul of the former Securities and Exchange Act, was fully enforced in September 2007, the basic legal framework regulating securities companies remains intact. The FIEA defines the four financial instruments businesses as including the Type I and Type II Financial Instruments Businesses, the Investment Advisory and Agency Business, and the Investment Management Business. What has traditionally been known as the securities business is included in the Type I Financial Instruments Businesses (Article 28, Paragraph 1 of the FIEA), and, accordingly, securities companies are required to register with the prime minister as Type I Financial Instruments Business Operators (Article 29).

The securities business registration system that had been in place since 1948, when the Securities and Exchange Act was first enacted, was replaced by a licensing system in April 1968. The licensing system was designed to help stabilize the management of securities companies by curbing excessive competition and obligating them to specialize (ban, in principle, on concurrently operating non-securities business), thus strengthening the investor protection. As a result, the regulatory regime increasingly took on a defensive bias, and virtually no companies entered the securities business anew.

However, as the securities market developed, the types of financial products handled by securities companies became increasingly diverse. Furthermore, as the years rolled on into the 1990s, customer needs for securities services started to change and vary, from private equity and asset securitization to M&A advisory, asset management, and online brokerage, against the background of the nation's shifting industrial structure, aging population, dying traditional long-term employment practices, and ongoing information technology revolution (such as the proliferation of the Internet).

The licensing system did play a role in stabilizing the management of securities companies. On the other hand, there turned out to be a number of

Table XII-1. The Scope of Business of Securities Companies (Type I Financial Instruments Businesses), and Requirements

1. Type I Financial Instruments Businesses (Article 28 Paragraph 1, Items (i)–(v) of the Financial Instruments and Exchange Act (FIEA))	Securities-related business (FIEA Article 28, Paragraph 8)
<p>(1) Proprietary securities trading, intermediary, brokerage, or agency service of securities, market transactions of derivatives or foreign market derivatives transactions; intermediary, brokerage, or agency service for the entrustment of the transactions listed above; brokerage for the clearing of securities, etc.; secondary distribution of securities; or the handling of public, primary offering or secondary distribution of securities or the handling of the private placement of securities</p> <p>(2) Intermediary, brokerage, or agency service of commodity-related market derivatives trading; intermediary, brokerage, or agency service for the entrustment of the transactions listed above; or brokerage for clearing</p> <p>(3) Intermediary, brokerage, or agency service of OTC derivatives trading and brokerage for clearing of such transactions</p> <p>(4) "Underwriting" of securities</p> <p>(5) Sale or purchase of securities or intermediary, brokerage, or agency service thereof, which is conducted through an electronic data processing system and in which a large number of persons participate simultaneously as a party or parties of the transaction (business of operating a proprietary trading system (PTS business))</p> <p>(6) Acceptance of deposit of securities, etc., in relation to the transactions, etc., listed above or book-entry transfer of stocks or corporate bonds (securities management business)</p> <p>Note: (5) requires approval (Article 30, Paragraph 1). PTS stands for Proprietary Trading System.</p>	<p>Of the Type I Financial Instruments Businesses listed, the business that corresponds to the conventional securities business (in principle, the scope of business which financial institutions are prohibited from conducting).</p> <p>Refusal of Registration (i.e., registration requirements) (Article 29-4, Paragraph 1 of the FIEA, Article 15 of the FIEA Enforcement Order)</p> <p>(1) An applicant who had his/her registration rescinded and for whom five years have not passed since the rescission; an applicant who has been punished by a fine for violating the provision of any applicable law or regulation and for whom five years have not passed since the imposition of the fine</p> <p>(2) An applicant with an officer, etc., who is bankrupt or has received certain criminal punishment and for whom five years have not passed since the completion of the sentence</p> <p>(3) An applicant without appropriate personnel resources to properly conduct the financial instruments business</p> <p>(4) An applicant with stated capital or net worth of less than ¥50 million</p> <p>(5) An applicant that is not a corporation</p> <p>(6) An applicant whose additional business other than incidental or registered/approved concurrent business is found to be against the public interest or to pose difficulty in risk management</p> <p>(7) An applicant whose major shareholder (with 20% or more of voting rights) is disqualified for registration</p> <p>(8) An applicant with a capital-to-risk ratio less than 120%</p> <p>(9) An applicant with a trade name that is the same as or similar to that of an already existing Financial Instruments Business Operator</p> <p>Minimum Capital Requirement (Article 15, Paragraphs 7 and 11 of the FIEA Enforcement Order)</p> <p>(1) When conducting wholesale underwriting as a lead managing underwriter: ¥3 billion</p> <p>(2) All other underwriting: ¥500 million or more</p> <p>(3) Business of operating PTS: ¥300 million</p> <p>(4) All other Type I Financial Instruments Businesses: ¥50 million</p>
2. Incidental businesses (Article 35, Paragraph 1, Items (i)–(xv))	<p>(The following items are newly included as incidental businesses under the FIEA.)</p> <p>(10) Custody of assets of a registered investment corporation</p> <p>(11) Provision of consultation to any other business with regard to assignment of a business, merger, spin-off, share exchange or share transfer or intermediation thereof</p> <p>(12) Provision of management consultation to any other business</p> <p>(13) Sale or purchase of currencies and other assets related to derivatives trading or intermediary, brokerage, or agency service thereof</p> <p>(14) Sale or purchase of negotiable deposits or other monetary claims or intermediary, brokerage, or agency service thereof</p> <p>(15) Management of assets under its management as investment in specified assets defined in the Investment Trust Act</p>
3. Other businesses requiring notification (Article 35, Paragraph 2 of the FIEA; Article 68 of the Cabinet Office Order on Financial Instruments Business, etc.)	<p>(6) business pertaining to lease of real properties owned by a Financial Instruments Business Operator itself; (7) goods leasing business; (8) business pertaining to creation and sale of computer programs for the business of any other business operator, and a business to accept the entrustment of computing service; (9) business of management of the defined contribution pension; (10) Trust Agreement Agency Business; (11) intermediary service for forming a trust by will or concluding a contract for the disposition of an estate of a deceased party; (12) Financial Institution Agency Service; (13) real property management business; (14) advisory business related to real property investment; (15) business of trading emission rights and emission derivatives or acting as an intermediary, broker or agent thereof; (16) business of undertaking administrative operation entrusted by an investment corporation or a special-purpose company; (17) business of investing money or other properties for other person, as an investment in assets other than securities or rights pertaining to a derivative transaction; (18) business of concluding a contract for a guarantee or assumption of an obligation, or an intermediary, brokerage or agency service thereof; (19) business of making an arrangement with or introducing another business operator, to customers of its business; (20) business of creating any advertisement or promotion in regard to the business of any other business operator; and (21) funds transfer business.</p>

Notes: 1. A Financial Instruments Business Operator may, in addition to the above, engage in a business for which approval has been obtained from the prime minister (approved business, Article 35, Paragraph 4 of the FIEA).

2. A discretionary investment contract is now included as "investment management business", which is one of the independent investment management businesses that can be conducted without special approval from the prime minister.

drawbacks, including a detriment to creativity in business approaches, such as branch network management and the development of new products and services and a lower sense of self-reliance on the side of securities companies. Increasingly concerned about such negative fallout, the government amended the Securities and Exchange Act as part of the Act on Revision, etc. of Related Acts for the Financial System Reform, and a new registration system replaced the licensing system for the securities business in December 1998.

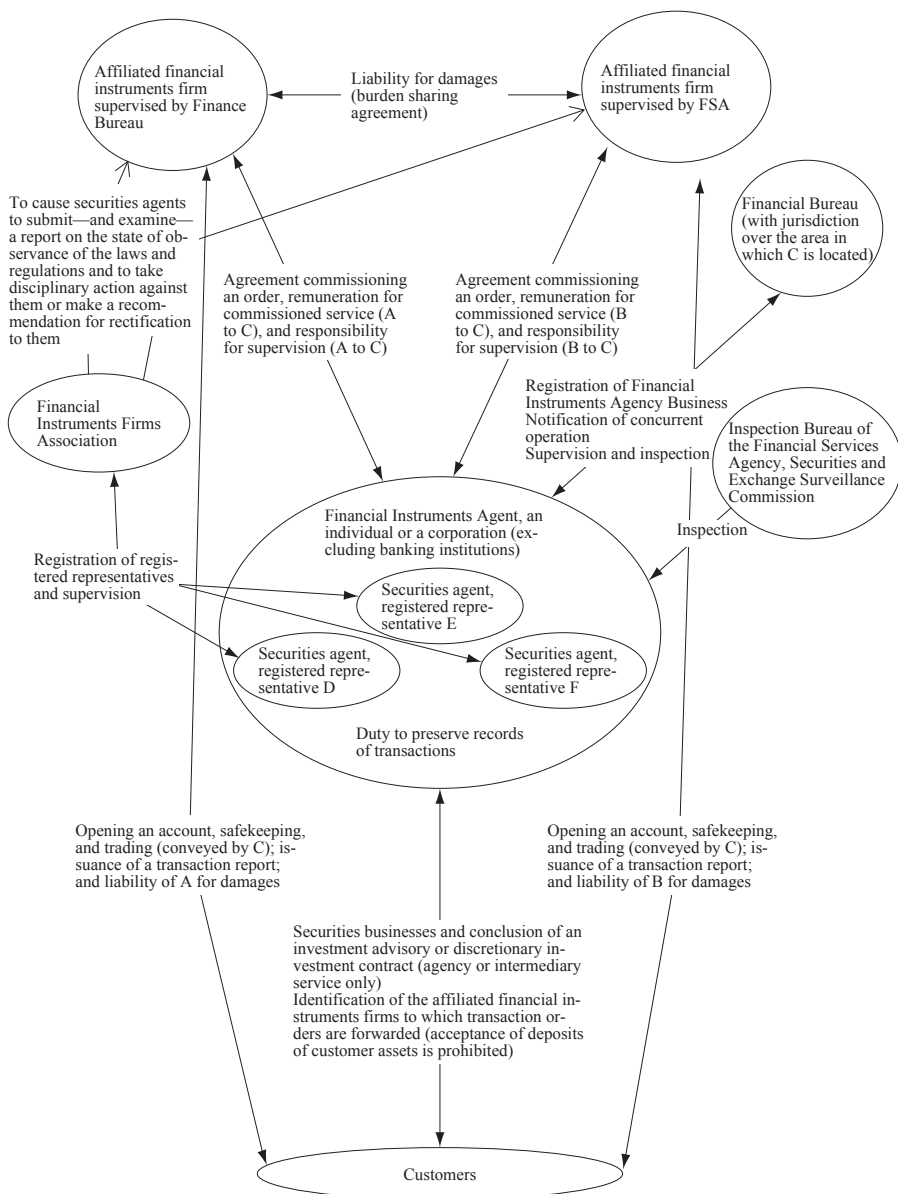
With the objective of providing an equal and uniform investor safeguard across various financial products and services with considerable risk, the FIEA was subsequently enacted to cover a wider range of objects, including collective investment schemes and derivatives trading. The FIEA is comprehensive legislation that combines the Securities and Exchange Act, the Financial Futures Trading Act, and the Investment Advisory Services Act, and aims at achieving effective regulation of a unified financial instruments business across a securities-related industry once vertically segmented into the securities business, financial futures trading business, and investment advisory business. Also as a result of amendments to the Financial Instruments and Exchange Act in 2012, commodity derivatives trading was added to the Type I Financial Instruments Business.

2. Overview of Financial Instruments Business Operators (Securities Companies) (2)

The former securities intermediary service is redefined as “Financial Instruments Intermediary Service” under the FIEA. The term “Financial Instruments Intermediary Service” means services comprising the following acts conducted under entrustment from a Type I Financial Instruments Business, an investment management business, or a registered financial institution (see section 12): (1) intermediation for the sale or purchase of securities (excluding PTS transactions); (2) intermediation for the sale or purchase of securities conducted in an exchange market or market transactions of derivatives; (3) handling of a public, primary offering or secondary distribution of securities or handling of a private placement of securities; and (4) intermediary service for the conclusion of an investment advisory contract or a discretionary investment contract (Article 2, Paragraph 11 of the FIEA). As is common with the items listed above, the provider of the service does not have customer accounts but solicits customers and redirects their orders for transactions to brokers/dealers, etc., from which it receives a commission.

Compared with the former definition for securities intermediary service, an intermediary service for derivatives trading and intermediary service for

Chart XII-1. An Outline of Financial Instruments Intermediary Service Providers



Note: More than one agreement commissioning an order is allowed.

Source: Compiled on the basis of the data drawn from materials published by the Financial Services Agency.

the conclusion of an investment advisory contract or a discretionary investment contract are newly included in the new financial instruments intermediary service. In spite of the expanded coverage, however, the underlying regulatory principles remain intact. The provisions of the FIEA are designed to ensure the protection of investors by instituting a number of preventive measures. More specifically, they require all financial instruments intermediary service agents to be registered and prevent any disqualified person from becoming an agent. The FIEA makes all agents subject to the same set of prohibited and regulated acts that are applicable to Financial Instruments Business Operators (the prohibition of loss compensation, the duty to observe the suitability rule, etc.); explicitly defines agents under the control and authority of securities companies employing them; and holds these securities companies legally responsible for supervision and damage compensation. The FIEA also gives the regulatory authority power to inspect and supervise financial instruments agents.

Registration requirements for financial instruments agents under the FIEA are essentially identical to those for the securities intermediary service under the former law. The requirements are less stringent than those for Type I Financial Instruments Business Operators to facilitate their market entry. More specifically, (1) either an individual or a legal entity can register as an agent and a legal entity does not need to be a corporation and (2) there are no minimum requirements for capital, net worth, or capital-to-risk ratio. However, they can only solicit investors for orders and redirect such orders to their broker/dealer. They are not allowed to take a deposit of cash or securities from their customers. (For this reason, they are exempt from joining an investor protection fund.) As is the case with registered representatives of Financial Instruments Business Operators, salespersons of financial instruments agents shall be qualified as registered representatives and register with the Japan Securities Dealers Association (JSDA) (as an Authorized Financial Instruments Firms Association).

Financial instruments agents may be affiliated with one or more securities companies. As of the end of September 2017, for example, there were 852 actual financial instruments agents (537 companies and 315 individuals) acting as a total of 1,139 agents (785 companies and 354 individuals). According to the Financial Services Agency's "List of Financial Instruments Intermediary Service Providers," many agents are affiliated with mid- and small-sized securities companies and Internet securities companies seeking to expand their sales networks, such as the 388 agents affiliated with Ace Securities and the 166 agents affiliated with SBI Securities. As registered financial institutions may also conduct the financial instruments intermediary service, banking institutions may provide a securities agency service with respect to stocks, corporate bonds, and foreign bonds (please see section 12). As a re-

sult, major securities companies are eager to conclude securities agency service contracts with regional financial institutions.

3. Overview of Financial Instruments Business Operators (Securities Companies) (3)

For quite some time after the war, securities companies in Japan had one characteristic in common: heavy reliance on the stock brokerage business

Table XII-2. The Number of Securities Companies and Their Capital and Employees

Year-end	Securities companies (head office)			No. of business offices (incl. head offices)	Total Capital (¥100 million)	No. of employees	
	Members of the stock exchange	Nonmembers of the stock exchange	Total			No. of office bound employees	No. of registered representatives
2010	115 (10)	184 (13)	299 (23)	2,220 (24)	18,289	16,143	75,913
2011	113 (8)	179 (14)	292 (22)	2,211 (24)	19,585	15,911	76,776
2012	103 (6)	168 (11)	271 (17)	2,138 (17)	17,349	13,372	69,684
2013	101 (6)	157 (10)	258 (16)	2,106 (17)	17,378	12,256	82,976
2014			253 (16)	2,107 (18)	17,539	13,016	85,358
2015			252 (13)	2,130 (15)	17,936	13,562	88,108
2016			260 (11)	2,142 (13)	18,352	14,552	89,942
2017			263 (11)	2,163 (13)	18,561	14,319	77,782

Notes: 1. Figures in parentheses represent the number of branches of foreign securities companies in Japan included in the figures above them. Their Tokyo branches are counted as head offices.

2. Number of companies, number of branches, amount of total capital, and number of employees for 2017 are as of the end of June of the year. The number of employees does not include 3,509 registered representatives employed by Financial Instruments Intermediary Service Providers (as of the end of June 2017).

3. Foreign securities companies are excluded from the amount of capital.

4. By virtue of an amendment dated April 16, 2003, the definition of “commission-registered representative” and qualification requirements were abolished, and the indication of category of members of the stock exchange was abolished at the end of March 2014.

Source: Compiled based on the data issued by the Japan Securities Dealers Association, *Shoken gyoho* (JSDA Monthly Report), *Gyomu houkokusho* (JSDA Operation Report), etc.

Table XII-3. JSDA Member Categories

(March 31, 2016)

	Securities business operator	Non-securities business operator	Breakdown		
			Asset Management Service	FX (FOREX Margin Transactions)	Others
Domestic brokers: 185 firms	142	43	22	16	5
Foreign brokers: 64 firms	39	25	22	3	

Note: Non-securities business operator refers to a business operator whose primary business is not the securities business. “Asset Management Service” refers to investment management and sale of structured funds and securitized products. The number of foreign brokers is estimated by the author.

Table XII-4. Breakdown of 142 Japanese Brokers (securities-related) by Controlling Shareholder, Size, Region and Business Characteristics

Large securities companies (2 Nomura-affiliated, Daiwa): 3	Bank-affiliated 22 companies		Second-tier small & midsize (face-to-face) 83 companies	Online brokers 9 companies	
Listed securities companies: 16	Breakdown	Megabank-affiliated: 5	Breakdown	Tokyo: 20	PTS specialists 6 companies
		Regional bank-affiliated: 14		Osaka: 8	
		Other bank-affiliated: 3		Regional: 55	Others 3 companies

both in terms of revenues and business volume. In the process, (1) there developed a bipolarization of securities companies—integrated securities companies that hired a large number of employees and ran multifaceted securities business on a large scale, on the one hand, and small and midsize securities companies that relied on the brokerage business generated by commission-registered representatives, on the other—and (2) the large integrated securities companies—Nomura, Daiwa, Nikko, and Yamaichi, collectively referred to as the “Big Four”—captured a large share of the market in all segments of the securities business. And they had gained an oligopolistic control of the market as a group by creating a network of affiliated small securities companies. This was a major characteristic of the postwar securities market of Japan, unknown before the war or in other countries. And this structure was maintained until the latter half of the 1990s with only minor changes.

However, in the 1990s, after the speculative bubble finally burst, the securities slump worsened and Yamaichi Securities and a number of smaller securities companies went bankrupt in the process in 1997 and afterward. In addition, large securities companies abandoned the strategy of forming a network

of affiliated small and midsize securities companies, making the management of securities companies increasingly fluid. Around the same time, large banks, etc. acquired the right to manage securities companies while a number of firms that were armed with a unique business style and focused on selected segments of the securities business have entered the market.

In addition, a number of foreign securities companies have opened branches in Japan. Since 1990, some have increased their shares in the equity and derivatives trading markets in their existing securities business, largely thanks to increases in orders received from their overseas customers. They are playing a major role in new types of business, such as the securitization of assets, packaging structured bonds, and M&A.

With the enforcement of the Financial Instruments and Exchange Act in 2007, the JSDA widened its member eligibility requirement from ‘securities companies’ to ‘Type I Financial Instruments Business Operators’ (see section 9), allowing entities that do not engage in the securities-related business as their primary business to register under the Type I Financial Instruments Business and become members of the JSDA. Over the nine years between April 2007 and March 2016, 134 companies left (of which 56 were mergers, 59 were voluntary business closures), while 79 companies entered (of which 58 were newly registered) the business, reflecting fluidity of the industry. While there are 11 foreign securities companies with operating sites in Japan (as of September 30, 2017), many more foreign entities are actually in operation through the establishment of a Japanese subsidiary, conversion to a Japanese corporation, or acquisition of a domestic securities company (see Table XII-3).

As such, the Japanese securities industry, where the “Big Four” (Nomura, Daiwa, Nikko, and Yamaichi Securities) used to have an oligopolistic control of the market and where brokering was the core and standard operation, changed drastically, resulting in having diverse players, such as foreign entities and banks, hold stakes in securities businesses. And as the securities business itself became increasingly diverse to cover operations other than brokerage, a growing number of firms whose primary business is not a securities-related business have entered the market.

4. Securities Businesses (1)—The Principal Businesses (1)

The principal businesses that securities companies are authorized to conduct under the Financial Instruments and Exchange Act (FIEA) have been expanded and are referred to as the Type I Financial Instruments Businesses. By product, principal businesses may be largely divided into those relating to stocks, bonds, investment trusts, and derivatives. By type of service, they

Table XII-5. Business Volume Handled by TSE and OSE Member Companies

	Cash Stock Transaction Value (Trillions of yen)			Listed Derivatives Trading (Trillions of yen)
	Proprietary	Agency	Traded on margin (%)	Notional principal (stocks, bonds, etc.)
2005/3	287	503	20	1,421
2006/3	441	886	21	2,007
2007/3	525	982	18	2,273
2008/3	552	1,036	16	2,776
2009/3	381	665	18	1,846
2010/3	291	540	21	1,467
2011/3	243	595	16	1,632
2012/3	152	537	15	1,420
2013/3	177	672	17	1,888
2014/3	273	1,348	21	2,295
2015/3	249	1,174	18	2,381
2016/3	285	1,317	15	2,689
2017/3	280	1,212	14	2,178

- Notes: 1. The accounting year runs from April 1 to March 31 of the following year.
2. Figures are double the actual volume because both sales and purchases are included.
3. Cash stock transaction volumes are those handled by 92 general members (including foreign securities companies, as of March 31, 2017).
4. Of these members, 82 members also participate in derivatives trading on the OSE.
5. In addition, 27 financial institutions participate in JGB futures trading on the OSE.
6. Derivatives trading include those executed on the former TSE prior to the integration.

Source: Compiled from statistical data issued by Japan Exchange Group

may be largely divided into those relating to (1) dealing—proprietary trading; (2) brokerage—agency trading; (3) investment banking—underwriting; and (4) public offering and private placement—distribution of securities.

The bulk of the securities-related business of brokers/dealers in the secondary market is the brokerage business of executing customer orders on stock exchanges, and the rest is the proprietary trading conducted for their own account. As not many customer orders for bonds—except for convertible bonds, whose prices are linked to underlying stock prices—are executed on stock exchanges, most bond orders are executed by matching them against the positions of securities companies' proprietary accounts (bond dealing). Along with stock exchanges, securities companies play an important role in forming fair prices and maintaining the liquidity of securities through their broker/dealer functions.

In addition to underwriting publicly offered new issues of public bonds

Table XII-6. PTS Transactions

(Billions of yen)

	Trading on Exchange (A)	Trading off Exchange (B)	Total (A)+(B)	PTS transactions (C)	Proportion of PTS Trading off Exchange (C/B)	Proportion of PTS Trading to Total (C/(A+B))
Mar. 2009	521,095	36,357	557,452	2,073	5.7%	0.4%
Mar. 2010	395,501	24,484	419,984	3,090	12.6%	0.7%
Mar. 2011	397,577	24,801	422,378	4,937	19.9%	1.2%
Mar. 2012	335,080	32,299	367,379	15,203	47.1%	4.1%
Mar. 2013	382,653	36,328	418,981	21,247	58.5%	5.1%
Mar. 2014	722,202	72,361	794,563	44,004	60.8%	5.5%
Mar. 2015	655,514	72,505	728,019	36,177	49.9%	5.0%
Mar. 2016	755,464	86,191	841,655	38,381	44.5%	4.6%
Mar. 2017	671,447	83,932	755,379	30,967	36.9%	4.1%

Notes: 1. The accounting year runs from April 1 to March 31 of the following year.

2. Figures are actual volume because only one side of the transaction is included.

3. Major PTSs include SBI Japannext and Chi-X.

Source: Compiled based on statistical data from the PTS Information Network.

(government securities, etc.), nonconvertible bonds of private business corporations, and equity securities (stocks and bonds with subscription rights/warrants) of public companies, securities companies also underwrite the shares of companies to be listed on exchanges, etc., in the process of initial public offerings. The term “underwriting” means an act of acquiring a security by a securities company with the aim of ensuring successful issuance of a new security or secondary distribution of shares by reselling them to others and, if so agreed, purchasing the unsold portion of the security, if any. More specifically, the act of acquiring new security from the issuer is called “wholesale underwriting” (and the securities company that negotiates a wholesale underwriting agreement with the issuer is called “the managing underwriter”), and acquiring the security from a wholesale underwriter is called “sub-underwriting.” Beneficiary certificates of investment trusts are also sold in public offerings, in addition to the new-issue securities mentioned above. Secondary distribution means the placing of already issued securities and includes block sales of major shareholders, etc.

In 1998, over-the-counter derivative trading and PTS services were newly authorized. The former refers to an act of effecting or entrusting to effect with a customer a forward or options trading of a stock or a stock index or a swap contract involving, for example, a stock index and an interest rate off

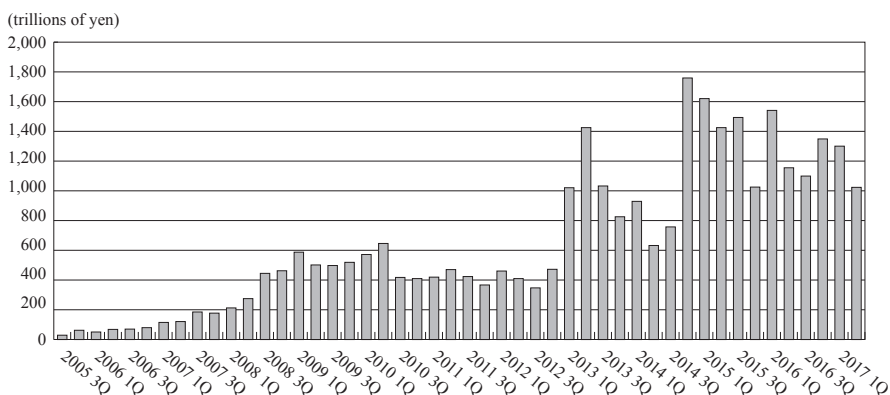
the exchange. Actually, most of these OTC derivative contracts are embedded in and sold as structured bonds (such as equity-linked bonds). The PTS service matches orders from investors by utilizing an electronic information processing system. As the PTS service requires specialized technical expertise and advanced risk management skills, securities companies wishing to provide the PTS service must be authorized to do so by the prime minister under the FIEA (see section 1 of this chapter).

5. Securities Businesses (2)—The Principal Businesses (2)

Because the Financial Instruments and Exchange Act (FIEA) combined the Securities and Exchange Act and the Financial Futures Trading Act, the Type 1 Financial Instruments Businesses includes financial futures, etc., as well as securities derivative trading. Moreover, the OTC derivatives business no longer requires authorization from the authorities (for an overview of the OTC derivatives business, see section 9 of Chapter 8).

The underlying assets of derivatives can comprise financial instruments, such as (1) securities, deposits, and currencies (Article 2, Paragraph 24 of the FIEA) and (2) financial indexes, such as price and interest rate of a financial instrument, and weather indexes (Article 2, Paragraph 25). In the 2012

Chart XII-2. OTC FOREX Margin Transactions



Notes: 1. Figures compiled based on reports from association members and special members.

2. Trading volume includes both buy and sell sides, including agency transactions.

3. Foreign currency amounts have been converted into Japanese yen using the spot rate at the end of each period.

Source: The Financial Futures Association of Japan.

Table XII-7. OTC CDF Transactions on Securities

	March-end 2012	March-end 2013	March-end 2014	March-end 2015	March-end 2016	March-end 2017
Number of Accounts	145,258	101,196	102,939	105,790	123,137	148,692
Margin Deposit Balance (100 million yen)	82	63	77	107	152	161

(Transactions)

	Individual stock related	Stock index related	Bond related	Other securities related	Total
FY2014					
Transaction amount (100 million yen)	807	83,737	1,460	11	86,015
Number of transactions	102,463	2,354,873	7,867	603	2,465,806
Open interest (100 million yen)	20	196	61	1	278
FY2015					
Transaction amount (100 million yen)	949	129,494	2,031	32	86,015
Number of transactions	191,989	4,825,379	12,154	14,616	2,465,806
Open interest (100 million yen)	14	237	32	2	278
FY2016					
Transaction amount (100 million yen)	795	80,886	2,463	876	85,020
Number of transactions	145,694	3,393,572	17,828	336,316	3,893,410
Open interest (100 million yen)	22	247	27	6	302

Note: Transaction amounts and open interest are on a notional principal basis. Open interest is as of the end of the fiscal year. Figures represent the sum of transaction value, etc. of JSDA regular and special members.

Source: Compiled from materials issued by the Japan Securities Dealers Association.

amendment of the FIEA, the definition of financial instrument was expanded to include commodities (excluding rice). The main customers for derivatives are financial institutions or institutional investors. In addition to acting as swap intermediaries, securities companies typically use OTC stock options as sweeteners for structured bond issues or conclude interest rate or currency swap agreements with companies issuing foreign currency denominated bonds when underwriting the issue.

Although individual investors are not frequently users of OTC derivatives, other than Nikkei 225 mini-futures (Osaka Exchange), foreign exchange (FX) transactions are among the products that they use relatively often. Investors use OTC FX transactions to purchase or sell currencies by depositing a margin with the broker and settle the transaction usually on a net basis.

These OTC transactions got their start in Japan when some commodity traders became the first to use them following the deregulation of foreign exchange transactions through the 1998 amendment of the Foreign Currency and Exchange Law (currently Foreign Exchange and Foreign Trade Act.) These FX transactions enable high leverage factors of 20 times on average and up to 100 times on small margins.

Without any laws or regulations initially, problems did occur in the FX market, resulting in the 2005 revision of the Financial Futures Trading Act, currently included in the Financial Instruments and Exchange Act. The revised law introduced a registration system for the FX business, which steadily eliminated many of the bad operators. As a result, there was a sharp expansion in the use of FX transactions, as can be seen in Chart XII-2. Moreover, in a bid to make FX transactions more transparent, the Tokyo International Financial Futures Exchange (TIFFE, now TFX) listed an FX product in 2005 called Click 365. The ceiling on leverage in FX transactions was lowered to 50 times in August 2010 and again to 25 times in August 2011.

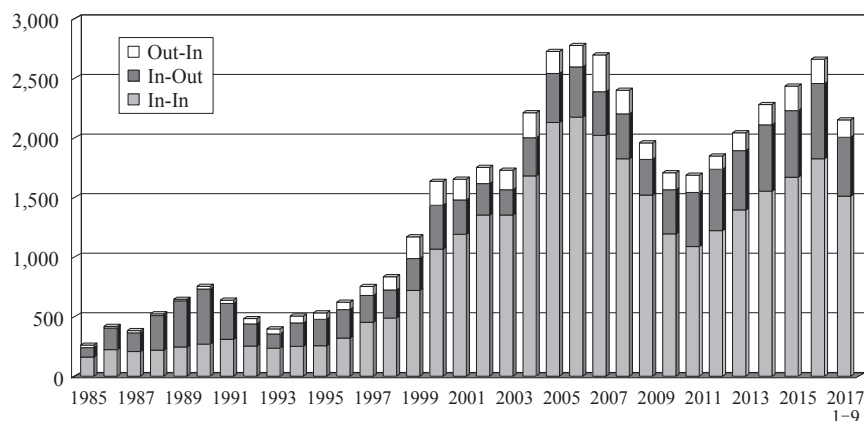
Today, investors have shifted from face-to-face transactions with brokers to online brokers for FX transactions, with Internet trading specialist FX firms, such as Gaitame.com and Gaitame Online, aggressively developing the market. This type of OTC trading, where investors can place orders with low margins and settle the contracts on a net basis, is called contract for difference (CFD transaction) and is available not only for FX but also for securities, indexes, interest rates, and commodities. First emerging in the United Kingdom, CFDs are now available from a number of brokers in Japan (see Table XII-7).

6. Securities Businesses (3)—Incidental Business, Concurrent Business, and Other Businesses

In addition to the principal businesses outlined in the foregoing, securities companies may conduct businesses incidental to their principal businesses and other businesses that require notification to the authorities. Management of assets of investment trusts, those entrusted under discretionary investment contracts, or properties pertaining to collective investment schemes used to require notification only, but, under the FIEA, securities companies are required to make registration in order to conduct this type of “investment management business” (Article 28, Paragraph 4). The registration requirements, however, are equivalent to those for the Type I Financial Instruments Businesses.

The volume of margin trading, or transactions in securities that are lent on margin to customers or financed by margin loans extended to them, began to

Chart XII-3. Changes in the Number of M&As Involving Japanese Companies



Note: In-In signifies M&A between Japanese firms. In-Out signifies M&A initiated by a Japanese firm against a foreign firm while Out-In signifies M&A initiated by a foreign firm with respect to a Japanese firm. Figures for 2017 are for January through September.

Source: Compiled from the data section of MARR magazine, RECOF Corporation.

Table XII-8. Number of Wrap Accounts and Assets Under Management

(¥100 million)

	Discretionary investment		Investment advisory		Grand Total	
	No.	Amount	No.	Amount	No.	Amount
March-end 2010	41,773	5,696	317	22	42,090	5,718
March-end 2011	43,509	5,890	260	17	43,769	5,907
March-end 2012	42,467	5,799	5	6	42,472	5,805
March-end 2013	51,758	7,689	0	0	51,758	7,689
March-end 2014	105,706	13,760	0	0	105,706	13,760
March-end 2015	307,346	38,973	0	0	307,346	38,973
March-end 2016	482,217	57,776	4	0	482,221	57,776
March-end 2017	564,622	65,702	0	0	564,622	65,702
June-end 2017	590,835	69,272	0	0	590,835	69,272

Note: A wrap account is an account that is managed for a flat fee covering fees for investment advisory, trading commission expenses, account management fees, etc. in proportion to the balance of managed assets.

Source: Compiled from statistics produced by the Japan Investment Advisers Association.

increase around 1999, and it has been accounting for approximately 14 to 20% of agency transactions in the 2000s (see table in Section 4). The term “securities lending and borrowing” refers to the lending and borrowing of stock or bond certificates and is also known as stock lending or bond repurchase agreements (repo). As a lending broker demands a borrowing investor to pledge cash as collateral, these transactions may also be considered as a means of financing secured by stock or bond certificates, and therefore a bond repo transaction is equivalent to a bond gensaki transaction economically. This practice makes it easier for securities companies to finance stocks, bonds, and cash and hence to accept large orders or basket orders from customers. For this reason, it contributes to the formation of fair prices of securities and improves the liquidity of the market. By “consultation with any other business operator with regard to a business assignment, merger, company split, share exchange or share transfer, or intermediation for these matters” is meant the M&A consulting service that an investment bank provides to its clients with respect to the spinning off of a business division, the computation of an IPO price, or an acquisition offer, etc.

Major securities companies, including the top- and second-tier brokers, also registered themselves under the investment management service and have started to market a “wrap account” discretionary investment service and to launch and manage collective investment schemes to invest in nonpublic companies, real estate, and others. As of the end of June 2017, according to a survey by the Japan Investment Advisers Association, there were a total of 590,835 wrap accounts in the industry, holding approximately ¥6,927.2 billion, reflecting a stable increase. Major brokers, foreign affiliates, and securities subsidiaries of mega-banks focus on M&A; structuring of private equity funds; and securitization (defined as business to trade monetary claims and requires notification), collectively known as investment banking services, along with securities underwriting, which is often conducted in association with these services.

In addition, following the full deregulation of brokerage commissions (in October 1999), low-commission online stock brokers offering service over the Internet have emerged, and their share of the market has been increasing rapidly. The number of online brokers stood at 70, with the number of accounts rising to 23.33 million at the end of March 2017. The value of cash stock and margin transactions of these online brokers during the period between October 2016 and March 2017 amounted to ¥144,086.9 billion, accounting for 21.3% of the total value of agency transactions, and the online brokers sold ¥708.2 billion worth of investment trust units according to the JSDA Monthly Report for July 2017. Growth in the business of Internet brokers was particularly notable.

7. Income and Expenditure of Financial Instruments Business Operators (Securities Companies)

Sources of revenue for securities companies include (1) brokerage commission; (2) management and underwriting fees; (3) selling concessions from public offerings and secondary distributions; (4) trading income (net of trading losses); (5) financial income in the form of interest on loans made in con-

Table XII-9. General Trading Participants of TSE Non-Participants of TSE

(Millions of yen)	Term ended March 2007	FY2016	Change ratio (%)	Term ended March 2007	FY2016	Change ratio (%)
No. of companies	110	92		193	163	
Operating income	4,457,603	3,391,856	− 23.9%	228,881	564,702	146.7%
Commissions received	2,797,143	1,862,705	− 33.4%	159,644	271,338	70.0%
Brokerage commissions	987,622	517,109	− 47.6%	54,925	41,541	− 24.4%
Underwriting fees	214,388	164,245	− 23.4%	878	2,254	156.7%
Selling concession	400,042	274,078	− 31.5%	16,861	24,600	45.9%
Other fees and commissions	1,194,946 (26.81%)	907,153 (26.75%)	− 24.1%	87,125 (38.07%)	203,063 (35.96%)	133.1%
Trading profit/loss	821,560	893,868	8.8%	35,227	219,358	522.7%
Financial income	828,621	627,832	− 24.2%	19,321	23,867	23.5%
(Profit from margin trading)	118,911	85,604	− 28.0%	5,148	1,802	− 65.0%
Financial expenses	630,482	388,464	− 38.4%	16,216	28,147	73.6%
(Margin trading expenses)	29,582	16,615	− 43.8%	3,844	901	− 76.6%
(Interest expense)	149,043	47,869	− 67.9%	2,670	11,509	331.0%
Other operating income	10,279 (0.23%)	7,451 (0.22%)	− 27.5%	14,689 (6.42%)	50,139 (8.88%)	241.3%
Net operating income	3,827,064	3,003,341	− 21.5%	212,721	536,605	152.3%
Selling, general and administrative expenses	2,825,201	2,352,201	− 16.7%	218,005	470,937	116.0%
(Transaction-related expenses)	550,670	481,723	− 12.5%	35,845	248,306	592.7%
(Personnel expenses)	1,311,480	938,641	− 28.4%	119,601	120,549	0.8%
Operating profit/loss	1,001,828	651,134	− 35.0%	− 5,249	65,673	−

Note: The figure at the bottom of the “Other fees and commissions” column and “Other operating income” column represents the ratio to operating income. Effective April 2014, members are not required to set their fiscal years to the end of March.

Source: Compiled from *Financial Overview of Regular Member Firms, JSDA and Earnings Summary of General Trading Participants*, TSE.

Table XII-10. Profitability Comparison by Member, Domestic or Foreign and Business Characteristics (FY2015)

	No. of companies	Return on equity	Operating profit on sales	Turnover rate	Leverage ratio
All-company	249	11.48%	23.46%	2.74%	17.88
of which, General Trading Participants	102	12.30%	25.74%	2.56%	18.68
Non-Trading Participants	147	4.78%	8.18%	5.14%	11.36
of which, Japanese securities-related	142	11.35%	23.05%	3.68%	13.39
of which, Foreign securities-related	39	11.26%	27.62%	1.12%	36.39
of which, Japanese non-securities-related	43	14.97%	18.76%	23.94%	3.33
of which, Foreign non-securities-related	25	16.52%	14.28%	64.72%	1.79

Notes: Return on equity = Operating profit/Net assets = (1) × (2) × (3)

(1) Operating profit on sales = Operating profit/Net operating income (2) Turnover rate = Net operating profit/Total assets (3) Leverage = Total assets/Net assets Difference in profitability is more clearly reflected in a comparison by domestic or foreign and by business characteristics as well as by Trading Participant or not.

Source: Calculated based on data issued by the Japan Securities Dealers Association.

junction with margin trading and lending fees on shares lent to customers, lending fees on shares and bonds lent in conjunction with transactions other than margin trading (such as repos), collateral for shares or bonds borrowed, interest, and dividends and other distributions on securities held in inventory; and (6) other fees and commissions, including those received in connection with incidental or concurrent businesses, chiefly among them agency fees received from investment trust management companies for handling the payment of dividends and other distributions and fees from investment banking customers for the provision of information and advice, etc., on best capital policies and M&A opportunities.

On the other hand, expenditures of securities companies consist of (1) selling, general and administrative expenses (personnel expenses, rent and other real estate expenses, administrative costs, trade-related expenses, etc., and (2) financial expenses (interest and fees on brokers' loan and stock certificates borrowed from securities finance companies, etc. in connection with margin trading, interest and fees on brokers' loans and bonds borrowed in connection with repos, interest on bank loans and outstanding bonds, etc.). Revenues generated from the securities business are called "operating income." Subtracting financial expenses from that amount yields "net operating income," and net operating income less selling, general and administrative expenses is called "operating profit." Nonoperating profit or loss is added to operating profit to reach "current profit." Profit or loss, if any, from the sale of investment securities or real estate holdings and losses due to capital contribution

to affiliates, subsidiaries, etc. (such as nonbank lenders) are further added or deducted as extraordinary profit.

When compared with the circumstances of 10 years ago immediately before the financial crisis triggered by the collapse of Lehman Brothers, commission income, particularly from brokerage commissions, has slumped considerably. Underlying fees that account for 15% of commission received pertain to investment trust sales for the most part. “Other fees and commissions” form the largest source of income today, while “other operating income” that represents income from operations other than the securities business is also on the rise. The trend is evident namely for brokers that are not members of the TSE accounting for nearly half of the operating income. Major components are advice fees for M&A, etc., intermediary fees for OTC derivatives, etc., agency commission for investment trusts, fees for investment trust management, investment advisory fees for discretionary investment contracts, business tie-up fees, and foreign exchange margin trading commission.

As mentioned in Section 3, a total of 68 Japanese and foreign investment managers, fund and securitization structuring managers, FX specialists, etc. have entered the market. Most of these players are not members of the TSE. It appears that there is a growing diversity in the types of businesses handled.

8. Financial Condition of Financial Instruments Business Operators (Securities Companies)

Reflecting—and because of—the uniqueness of their business, the balance sheets of securities companies appear to be larger than they actually are. The biggest items on their balance sheets are “loans against the collateral of securities” and “borrowings against the collateral of securities.” These are deposits made in connection with the lending and borrowing of securities (see section 6). Funds received from the borrower of a bond or other security to secure them are treated as borrowings, while funds deposited with the lender of a bond or other security to secure them are treated as loans. The trading instrument is one that arises from the dealing of securities, and a net long position in cash securities (securities held for trading purposes) is entered on the debit side, and a net short position is entered on the credit side of the balance sheet. Derivatives (futures, options, and swaps) are marked to market, and unrealized gains are entered under the item of derivatives transactions on the debit side and under unrealized losses on the credit side. In case a transaction was not settled after execution, an amount equivalent to the value of securities sold is entered under the item of collateral account on the debit side, and an amount equivalent to the value of securities purchased is entered

Table XII-11. Major Accounts of Securities Companies in Japan (256 firms) as of March 31, 2017

Assets	In ¥ millions	Liabilities and capital	In ¥ millions
Cash and deposits	8,543,446	Trading products	31,452,408
Deposit	5,884,576	(Trading securities, etc.)	17,571,136
(Segregated customer asset trust)	5,194,142	(Derivatives trading)	13,881,257
Trading products	42,444,604	Collateral-for-contract account	699,011
(Trading securities, etc.)	27,477,769	Debt on margin trading	1,366,273
(Derivatives trading)	14,966,811	(Debt for margin trading)	429,219
Collateral-for-contract account	1,919,389	(Money received for securities lent for margin trading)	936,997
Assets for margin trading	3,246,971	Borrowings against the collateral of securities	68,387,879
(Money lent for margin trading)	2,653,892	Deposit received	4,236,393
(Cash collateral deposited to secure the securities lent for margin trading)	593,026	Guarantee money received	5,561,806
Loans against the collateral of securities	69,216,024	Short-term debt	13,968,423
Short-term guarantee money submitted	5,762,362	Total of current liabilities	127,233,563
Short-term loans	628,414	Long-term liabilities	5,488,273
Total of current assets	138,799,349	Total liabilities	132,860,042
Tangible fixed assets	181,255	Total Capital	1,941,572
Intangible fixed assets	361,249	Capital surplus	3,166,122
Investment, etc.	1,233,677	Retained earnings	2,483,410
(Investment securities)	916,123		
Total of fixed assets	1,776,412	Total capital	7,715,727
Total of assets	140,575,892	Total of liabilities and capital	140,575,892

Source: Compiled from materials prepared by the Japan Securities Dealers Association. These figures exclude those of companies that have suspended their operations. Totals may not match sums.

on the credit side. Securities companies hold both long and short positions in a security for the purpose of speedy execution of customer orders involving cash security, derivatives, or bond repos, as well as the pursuit of arbitrage gains, and, instead of netting them out, they are required to adhere to the trade-date accounting process with stringent risk management on a contract basis.

Incidentally, a loan to facilitate margin trading is made in an amount equivalent to the amount required to make the margin purchase of a security by a customer, and cash collateral is deposited with a securities finance company as a borrowed securities deposit. On the other hand, the cash for conducting margin trading is borrowed from a securities finance company, and it is equivalent to the amount that needs to be paid to a customer for the securities sold on margin.

Securities companies are required to keep customer assets segregated from

Table XII-12. Capital-to-Risk Ratio of General Trading Participant Members of the TSE (92 companies) as of June 30, 2017

The minimum ratio	203.2%
The maximum ratio	1676.9%
The median ratio	456.1%
The average ratio	513.5%
Distribution	
Those in the range of	
100% to 199%	0 company
200% to 299%	13 companies
300% to 399%	24 companies
400% to 499%	17 companies
500% to 599%	16 companies
600% to 699%	8 companies
700% to 799%	3 companies
800% or higher	11 companies

Source: Compiled from materials produced by the Tokyo Stock Exchange.

Table XII-13. An Outline of the Capital-to-risk Ratio Requirements for Type I Financial Instruments Business Operators (Securities companies)

(Article 46-6, Paragraph 1 of the FIEA and Article 178 of the Cabinet Office Order on Financial Instruments Business, etc.)

Capital-to-risk ratio = (non-fixed primary capital ÷ the equivalents of various risks) × 100%	
Non-fixed primary capital = Tier I item (equity capital) + complementary item (subordinated debt, allowance) – deducted assets (fixed assets, etc.)	Equivalents of various risks = market risk + customer risk + fundamental risks
Market risk = risk of loss that may arise from a fall in the prices of securities held by securities companies	
Customer risk = risk of a loss arising from the default by the other party to a transaction effected by securities companies	
Fundamental risks = risks that may arise in the ordinary course of business by mistakes made by members of the administrative department of securities companies	

Note: Large companies having assets totaling more than ¥1 trillion are designated as “Special Financial Instruments Business Operators” and are subject to primary capital regulations on a consolidated basis (Article 57-2, Paragraph 1 of the FIEA; as of September 30, 2017, 20 companies) Among such companies, since the shareholding companies of two groups—Nomura and Daiwa—correspond to the Designated Parent Companies prescribed in Article 57-12, Paragraph 1 of the FIEA (capital ratio against the entire group including the parent company and fellow subsidiaries), they are eligible for selecting the consolidated capital-to-risk ratio under the Basel III Accord.

Table XII-14. Orders Issued on the Basis of the Capital-to-Risk Ratio to Take a Prompt Corrective Action

Capital-to-Risk Ratio		
140% or less	Required to notify the regulatory agency	Art. 179 of the Cabinet Office Order on Financial Instruments Business, etc.
120% or more	Obligated to maintain ratio at such a level	Art. 46-6, Para. 2 of the FIEA
Less than 120%	- Denial to accept a registration application - Orders to change the method of business and deposit its property	Art. 29-4, Para. 1, Item (vi) of the FIEA Art. 53, Para. 1 of the FIEA
Less than 100%	Orders to suspend business for a period of three months or less	Art. 53, Para. 2 of the FIEA
Less than 100% and has no prospects for recovery	Cancellation of registration	Art. 53, Para. 3 of the FIEA

their own assets and to hold them in an outside trust (see section 11); this system is called “segregated customer asset trust.”

Ceilings on the ratio of individual products to the total net worth were used to control risks. However, as new products have since increased and the lesson was learned from Black Monday of 1987 (the market crash on Wall Street), the industry and the authorities became painfully aware of the need to control risk on a total basis. At the same time, the International Organization of Securities Commissions (IOSCO) called for the international harmonization of securities regulations. Against this backdrop, securities companies have been subjected to requirements for their capital-to-risk ratio. (The requirements were put into effect in 1990, and a law institutionalizing them was enacted in 1992.)

As securities companies handle products whose prices fluctuate in the market, their revenues are vulnerable to sudden changes in market prices. Therefore, a framework of capital-to-risk ratio regulations was put into place so that they can maintain their solvency and protect the interests of their customers even when the prices of their assets fall by providing for a sufficient amount of liquid assets against various risk contingencies.

9. Financial Instruments Firms Associations (1)

The former Japan Securities Dealers Association was regarded as the Authorized Financial Instruments Firms Association under the Financial Instru-

Table XII-15. Principal Functions of the Japan Securities Dealers Association (JSDA)

1. Self-Regulatory Operations	(1) Drawing up and enforcing self-regulatory rules	With a view to facilitating the efficient operation of the financial instruments market, the JSDA establishes various forms of self-regulatory rules applicable to Financial Instruments Business Operators, etc. and endeavors to ensure the fairness and efficiency of trading of financial instruments. The principal rules regulate: OTC trading in stocks and bonds, underwriting of securities, off-exchange trading in listed stocks, safe custody of securities, code of conduct of directors and officers, internal control system of member companies, qualifications and registration of registered representatives, advertising of member companies, solicitation and management of customers of member companies, financial instruments intermediary service, segregation and management of customers' assets, settlement of disputes with customers, and standardized accounting methods of securities-related businesses.
	(2) Auditing, monitoring, and self-regulating	The JSDA audits member companies to see whether they comply with the laws and regulations, the rules of self-regulation in carrying out business activities and other relevant rules and whether they have an adequate internal control system; monitors the operation of member companies and checks to see whether they segregate customers' assets; and takes actions to discipline member companies and their directors and employees who have violated the laws and the rules of self-regulation.
	(3) Qualification tests, qualification renewal training and registration of registered representative	The JSDA conducts qualification tests on registered representatives and on the personnel in charge of management and control, and carries out training for the renewal of qualifications. (The administrative work relating to the registration of registered representatives is commissioned by the prime minister.)
	(4) Settlement of securities-related disputes through the mediation of the JSDA and the handling of trade-related complaints of investors	Consultation regarding complaints concerning the business carried out by a member firm or by Financial Instruments Intermediary Service Providers; and mediation of a dispute between a member firm and a customer pertaining to securities transactions (complaint handling and dispute mediation have been commissioned to the Financial Instruments Mediation Assistance Center (FINMAC), a non-profit organization).
	(5) Services provided by the authorized personal information protection organization	The organization provides services for the proper handling of personal information of members of the JSDA as an authorized personal information protection organization under the Act on the Protection of Personal Information.
	In addition to general improvement of the securities market, such as a securities settlement reform, changes and amendments to the trading rules of the equity market, and measures to deal with new financial products (including new types of investment trusts and securitization-related products), the JSDA performs the following market administration functions.	
	(6) Enhancement and improvement of the bond market	(i) JSDA establishes and reviews the rules concerning transactions and practices in the over-the-counter market of bonds. (ii) JSDA publishes Reference Statistical Prices (Yields) for OTC Bond Transactions. (iii) JSDA collects materials and compiles statistics concerning the bond market.
	(7) Management of off-exchange trading of listed stocks	(i) JSDA takes steps to ensure the fairness and efficiency of off-exchange trading in listed stocks and the protection of investors. (ii) JSDA collects and publishes data on the volume of listed stocks traded off exchange and publicly announces in real time price quotations, contract, and other information on listed shares traded on PTSs.
2. Services to promote the sound development of financial instruments business and financial instruments market	(8) The expansion of the green sheet market	(i) JSDA manages green sheet and Phoenix issues (designation and cancellation). (ii) JSDA publishes information concerning green sheet issues (corporate information of their issuers, quotations, and trading volume, etc.). (iii) JSDA takes steps to improve the green sheet system and the unlisted securities trading system.
		(1) Investigates and studies the financial instruments market and publishes opinions (2) Establishes a common platform for the securities market (3) Makes public statistical material, etc., on the stock and bond markets (4) Disseminates knowledge about financial instruments, indexes, and markets and educates investors (5) Communicates and exchanges views with market-related organizations (6) Implements education and training programs (7) Supports actions to eliminate antisocial forces
3. International business and international exchange		Participates in international conferences, such as those of the International Council of Securities Association (ICSA), Asia Securities Forum (ASF), and International Organization of Securities Commissions (IOSCO), exchanges information with securities-related organizations of foreign countries, and promotes international exchange.

Note: The Self-Regulatory Organization is responsible for self-regulatory operations and market administration while the Securities Strategy Board is responsible for operations that promote the sound development of the securities market and the securities business.

Table XII-16. Permissible Forms of Business by Registered Representatives (JSDA Rules: Article 2, Regulations Concerning Qualification and Registration, Etc., of Sales Representatives of Association Members)

Class 1 Sales Representative	Sales representative who is authorized to engage in all acts of a sales representative with the exception of designated over-the-counter transactions of derivatives
Class 2 Sales Representative	Sales representative who is authorized to engage in all Acts of a Sales Representative related to any securities with the exception of stock subscription rights/warrants or covered warrants (excluding Acts of a Sales Representative related to securities derivative transactions or transactions in bonds with options, and limited to the cases prescribed by the detailed rules regarding margin transactions)
Special Member Class 1 Sales Representative	Sales representative who is authorized to engage in all Acts of a Sales Representative related to the business of a registered financial institution (with the exception of designated over-the-counter transactions of derivatives, financial instruments intermediary service of registered financial institution, or brokerage with written orders)
Special Member Class 2 Sales Representative	Sales representative who is authorized to engage in all Acts of a Sales Representative related to transactions of public and corporate bonds, commercial papers, investment trust certificates, etc. (excluding Acts of a Sales Representative related to securities derivatives trading or transactions in bonds with options)
Special Member Class 4 Sales Representative	Sales representative who is authorized to engage in all Acts of a Sales Representative related to “Specified Financial Instruments Business” (marketing of investment trusts and other specified acts of an insurance company or other financial institution)
Margin Trading Sales Representative	Sales representative who is authorized to engage in all Acts of a Sales Representative by a Class 2 Sales Representative and acts of a sales representative relating to margin trading (including “when-issued” trading)

Note: Qualification tests for Special Member Class IV Sales Representative and Margin Trading Sales Representative are not performed (as of September 2017).

ments and Exchange Act (FIEA). Under the FIEA, an association is composed of Type I Financial Instruments Business Operators (excluding OTC financial futures business operators) and must be authorized by the prime minister (Article 67-2, Paragraph 2 of the FIEA). The association aims to ensure the fair and smooth sale and purchase of securities, etc., and to contribute to the protection of investors and to enable the establishment of a market where over-the-counter securities are traded (Article 67, Paragraph 1 and 2). The principal functions of the association are (1) to undertake self-regulatory operations, (2) to undertake the financial instruments business and businesses that contribute to the development of the financial instruments market, and (3) to promote international businesses and international exchange (see Table XII-15). At present, the Japan Securities Dealers Association (JSDA) is the

country's only organization established as the Authorized Financial Instruments Firms Association under the FIEA.

In 1940, the government ordered securities companies to form one securities dealers association in every prefecture for the purpose of facilitating the wartime control of the securities market. After the war, the Japan Securities Dealers Joint Association was established in 1949 as a national federation. In 1968, 33 associations were consolidated into 10, and a single national body, the JSDA, with the 10 associations as regional units, was formed. At present, there are 9 regional associations: Hokkaido, Tohoku, Tokyo, Nagoya, Hokuriku, Osaka, Chugoku, Shikoku, and Kyushu. (The regional associations of Kyushu and South Kyushu were consolidated into one in 1995.)

Since securities company scandals came to light, pressure to strengthen the self-regulatory function of the JSDA has mounted, and the status of the JSDA was changed from a public-service corporation under the Civil Code to a legal entity under the Securities and Exchange Act in 1992, and the Ministry of Finance (currently, the prime minister) commissioned the JSDA to handle the registration of registered representatives. This helped define the status of the JSDA as a self-regulatory organization of the securities industry. In July 1998, the Bond Underwriters Association of Japan was consolidated into the JSDA, and in July 2004 the JSDA was reorganized into a structure consisting of the Self-Regulation Division, the Securities Strategy Division, and the General and Administration Division. As the JASDAQ Securities Exchange was established (see Chapter 11) in December 2004, the OTC securities market was closed, and the JSDA consolidated the Securities Information Center under its wing in April 2005.

In September 2007, the JSDA became the association authorized under the FIEA and established the Code of Conduct Committee in July 2011 to deliberate the code of conduct of member firms and make proposals. Handling of consultation matters and complaints from users of securities transactions and mediation of disputes between users have been commissioned to the Financial Instruments Mediation Assistance Center (FINMAC), a non-profit organization, since February 2010.

Registered financial institutions under the provision of Article 2, Paragraph 11 of the FIEA (see section 12) joined the JSDA as special members in 1994. As of September 2017, the JSDA had 264 regular members and 209 special members (including 131 banks, 13 foreign banks, 39 *shinkin* banks (credit unions), 11 life insurance companies, 4 property and casualty insurance companies, and 11 others).

10. Financial Instruments Firms Associations (2)

Unlike the Securities and Exchange Act, the Financial Instruments and Exchange Act (FIEA) provides for the comprehensive regulation of a diverse range of collective investment schemes (so-called funds) and investment trust beneficiary certificate sales businesses. Self-offerings by funds, investment trust beneficiary certificates sales businesses, and some other businesses are defined under the FIEA as Type II Financial Instruments Businesses (“Type II Businesses”). Because financial instruments, such as funds, etc., are not highly circulated, the registration requirements for Type II Businesses are lenient, such that even individuals may register as businesses. The underlying assets of funds, investment trust beneficiary certificates, and similar products cover a wide range of real estate, specified instruments, and other assets. Registered Type II Businesses, therefore, are not solely securities companies; many real estate companies also have entered the market.

As a result, the number of registered Type II Businesses had risen to 1,167 as of the end of September 2017, exceeding by roughly four times the number of Type I Financial Instruments Businesses (securities business, financial futures trading business, etc., hereinafter referred to as “Type I Businesses”). The lax registration requirements, however, have resulted in lawsuits regarding the solicitation for self-offerings, etc., of funds and other incidents requiring administrative discipline because of legal violations.

To address such issues, the Type II Financial Instruments Firms Association was established in November 2010 and designated as a Certified Financial Instruments Firms Association (FIEA, Article 78, Paragraph 1). The association aims to contribute to the fair and smooth operation of Type II Businesses as well as to their sound development and to investor protection. It was set up taking into account the self-regulatory systems of the self-regulatory organizations (SROs) already in place for Type II Businesses, investment management business, investment advisory and agency business, etc.

Establishing an “authorized” association in Japan requires the authorization of the prime minister of Japan. But “certified” associations are granted certification by the prime minister following their establishment. The Japan Securities Dealers Association is the only “authorized” association in Japan’s securities market. The country’s “certified” associations, however, include the Financial Futures Association of Japan; the Japan Investment Advisers Association; The Investment Trusts Association, Japan; and, of course, the Type II Financial Instruments Firms Association. The major difference between the two types of associations is that “authorized” associations are able to establish and operate OTC securities markets (refer to section 9).

Other than that single difference, “authorized” and “certified” associations

Table XII-17. Numbers of Registered Financial Instruments Business Operators and Related Financial Instruments Firms Associations

Business Category	Number of Registered Firms (as of September 30, 2017)	Related Financial Instruments Firms Associations	
Type I	291	(Authorized) Japan Securities Dealers Association	264 Regular members (as of September 30, 2017)
		(Certified) Financial Futures Association of Japan	143 Regular members (as of May 31, 2017)
Type II	1,167	(Certified) Type II Financial Instruments Firms Association	447 Regular members (as of October 2017)
Investment advisory and agency business	985	(Certified) Japan Investment Advisers Association	478 Investment advisory and agency members (March 2017)
Investment management business	359		273 Investment management members (March 2017)
		(Certified) The Investment Trusts Association, Japan	99 Investment trust members (October 2017)
			80 REIT members (October 2017)
Total	2,802 (total number of registrants)		
	1,953 (actual number of firms)		

Note: Of the 291 Type I businesses, 27 (FX specialists) are not members of JSDA, but have joined the Financial Futures Association of Japan. Because some firms are registered under multiple business categories and with multiple associations, the totals do not match the sum of the individual numbers.

Source: Produced using the Financial Services Agency's "List of Certified Financial Instruments Firms Associations" and "List of Registered Financial Instruments Business Operators" and data from associations' websites.

- In addition to the above, there are firms deemed to be Business Operators Engaging in Specially Permitted Business for Qualified Institutional Investors, etc. (the so-called firms handling funds for professional investors) that are not required to register, most of which are not members of any of the above Financial Instruments Firms Associations. (See the Financial Services Agency's "List of Qualified Institutional Investors and other Registered Special Business Operators.")

When one or more investor is a Qualified Institutional Investor and other investors (general investors) number 49 or less among investors in a collective investment scheme (fund), under the Special Provisions Concerning Specially Permitted Businesses for Qualified Institutional Investors, the financial instruments firm is exempt from registration and may conduct management and self-offering of the fund by submitting notification of such to authorities. (Art. 63, Para. 1 and 2)

Reference: Essentially, firms or individuals with special investment skills have been allowed to participate in the market without registering and only a duty to submit notification of their businesses in order to enable them to offer their superlative investment instruments to professional investors at low cost. Of course, there are firms or individuals within this group that achieve excellent results and become members of one of the above associations, thereby being covered by self-regulatory rules. However, there are also firms or individuals that clearly have gathered together one (1) Qualified Institutional Investor and 49 individual investors with the intention of using the provisions as a legal loophole to avoid registration of a Type II business or investment management business. Hence the amendments to the FIEA for limiting subscriptions to affluent groups that satisfy certain conditions were promulgated in May 2015 and then enforced in March 2016.

carry out the same self-regulatory operations. The associations are responsible for (1) forming rules and regulations, (2) inspecting members to determine their state of compliance with laws and ordinances and self-regulation rules, (3) disciplining members that have violated laws and ordinances and self-regulation rules, (4) resolving complaints and disputes involving members' businesses, (5) mediating conflicts about members' businesses, and (6) carrying out sales representative registration operations when so commissioned by the government authorities.

There are 1,953 firms registered under financial instruments businesses in Japan, with some firms being registered under multiple business categories and some being members of multiple SROs. In addition, there are 2,190 organizations classified as Business Operators Engaging in Specially Permitted Business for Qualified Institutional Investors, etc. that are not registered despite carrying out self-offerings of funds just like Type II Businesses (as of end of July 2017). Since almost all of these Business Operators Engaging in Specially Permitted Business for Qualified Institutional Investors, etc. were not covered by self-regulatory rules, causing troubles to arise, rules were strengthened under the amendment to the FIEA in 2015.

11. Investor Protection Fund

The purpose of an investor protection fund is to protect the claims that general customers have on the securities companies they deal with. As we saw in section 1, the 1998 amendment to the Securities and Exchange Act changed the licensing system of securities companies to a less-demanding registration system for securities business, encouraging non-securities companies to enter the securities market, and relaxed restrictions against conducting side business, liberalizing the lines of business that securities companies can undertake. And this created the need to take measures to protect investors from any unforeseen loss that they may suffer from insolvency of the securities companies they deal with. The government instituted provisions in the 1998 amendment to the Securities and Exchange Act (the present FIEA) with a view (1) to preventing bankruptcy of securities companies, empowering the Financial Services Agency to take a prompt corrective action on the basis of the capital-to-risk ratio (Article 53 of the FIEA) (see section 8) and as a framework to protect investors in case the securities companies they deal with went bankrupt; (2) to requiring securities companies to manage their customer assets separately (Articles 43-2 and 3); and (3) to establishing an investor protection fund (Articles 79-20 through 80). In line with this, the law concerning the bankruptcy proceedings of financial institutions (Act on Special Measures for the Reorganization Proceedings of Financial Institu-

Table XII-18. Investors Eligible for Compensation, Compensation Procedures, and Sources of Funds of the Investor Protection Fund

Those eligible for compensation	(1) Eligible persons (Art. 79-20, Para. 1 of the FIEA)	“General Customer” who conducts a Subject Securities-related Transaction or a Subject Commodity-related Derivatives Trading with a Financial Instruments Business Operator that conducts the securities-related business or commodity-related exchange derivatives trading agency service, etc. (excluding a Qualified Institutional Investor, central or local government, or any other person specified by a Cabinet Order)
	(2) Scope of customer assets eligible for compensation (Art. 79-20, Para. 3)	(i) Money or securities deposited as a margin for exchange transactions of derivatives, etc., or money or securities deposited as guarantee money for margin trading, etc.; (ii) money belonging to the account of or deposited by a customer with regard to a transaction pertaining to the Financial Instruments Business (such as advance payment for purchase, proceeds from a sale that have not been withdrawn, etc.); (iii) securities (securities deposited for sale or held in safekeeping); and (iv) other customer assets specified by a Cabinet Order
Compensation procedures	Notice and recognition (Art. 79-53 and 79-54)	When the Fund receives a notice from a Financial Instruments Business Operator or the Prime Minister, it shall recognize whether or not there is any difficulty for the firm to perform the obligation to return or refund customer assets pertaining to such notice.
	Public notice of recognition (Art. 79-55)	When a Fund has granted recognition to the effect that it is difficult for a notifying Financial Instruments Business Operator to perform the obligation to return or refund customer assets (such a Financial Instruments Business Operator referred to as the “Recognized Financial Instruments Business Operator”), it shall give a public notice that prompts the relevant customers to file a claim for the return or refund of their assets.
	Payment of claims eligible for compensation (Art. 79-57, Para. 4)	A Fund shall, when having made a payment to General Customers, acquire claims eligible for such compensation of the amount commensurate with its payment. The Fund shall collect the claims from the bankrupt Financial Instruments Business Operator through bankruptcy proceedings.
	Loans to a “Notifying Financial Instruments Business Operator” (Art. 79-59)	When the financial position of a “Notifying Financial Instruments Business Operator” has deteriorated to such a point that, while it does not yet face difficulties in returning and refunding customer assets, loans from the Fund could facilitate expedited return or refund, the Fund may make loans to such “Notifying Financial Instruments Business Operator.”
Source of funds	Investor Protection Fund (Art. 79-64 and 79-65)	Burden charges collected from member Financial Instruments Business Operators shall be the source of funds.
	Borrowing (Art. 79-72)	Borrowings from financial institutions may be made with the approval of the Prime Minister of Japan and the Minister of Finance.

Table XII-19. Comparison Between New and Former Systems

	Former System	New System
Name, Year of Establishment	Entrusted Securities Indemnity Fund (August 1969)	Japan Investor Protection Fund (December 1998)
Underlying Entity	Incorporate foundation with no legal basis	Corporation defined under the Securities and Exchange Act (current Financial Instruments and Exchange Act) (must be approved by the Prime Minister and the Minister of Finance)
Membership obligation	Voluntarily by each securities company	Compulsory membership
Contribution	Donation (subject to taxation)	Burden charges (tax deductible as expenses)
Limit of the amount as indemnity (Note)	¥2 billion per bankrupt securities company	¥10 million per customer
Past records	7 cases in and after May 1997 (succeeded by the new fund in December 1998)	<ul style="list-style-type: none"> · Minami Securities (went bankrupt in March 2000); indemnity amount of approximately ¥5.9 billion (including ¥2.4 billion returned from bankruptcy trustee) · Marudai Securities (went bankrupt in March 2012); indemnity amount of approximately ¥170 million

Note: Up till March 2001, however, a special provision on full indemnity was available (Article 4 of Revision Provisions of the Securities and Exchange Act).

Table XII-20. An Outline of the Investor Protection Fund

	Japan Investor Protection Fund	Securities Investors Protection Fund
No. of members (at the time the fund was established)	235 companies (224 domestic and 11 foreign-affiliated companies)	46 companies (1 domestic and 45 foreign-affiliated companies)
Scale of the fund	¥30 billion at the time of establishment; ¥50 billion at the end of March 2001	¥10 billion at the time of establishment (¥3 billion in cash and ¥7 billion guaranteed) and ¥5 billion in cash and ¥5 billion guaranteed after April 2001
Burden charge on members	A fixed amount and a fixed rate of burden charge (computed on the basis of the operating income and the number of registered representatives). The total of annual burden charge is ¥4 billion.	1% of the customer assets, and a bank guarantee of an amount equivalent to 50% of margin trading requirement. When the fund falls ¥1 billion or more short of ¥10 billion, members are asked to contribute an additional burden charge.
Remarks	The fund has taken over the compensation service provided by the Entrusted Securities Indemnity Fund and its entire assets and liabilities.	Members are required to have their books audited by outside auditors.
The two organizations were consolidated in July 2002 into the Japan Investor Protection Fund. As of 2017, there were 256 member firms and the size of the fund was approximately ¥57.3 billion (end of March).		

tions) was amended, and this amended law has become applicable to securities companies.

The system of the segregated custody of securities is designed to recover the assets of customers in preference to other creditors of a security company if it goes bankrupt by holding the cash and securities of its customers separately from its proper assets. It is done in two ways: (1) securities of its customers are managed separately and (2), with respect to a customer's cash and substitute securities deposited with the securities company as collateral for margin trading, etc., that are impossible to physically identify when they are rehypothecated, the securities company trusts in an outside account an amount equal to its customers' claim, net of their liability, to the securities company (this is called the "customer segregated fund"). If this system of separate management were strictly enforced, customers would not suffer any unforeseen loss even if their securities company went bankrupt. However, the rub is that the customer segregated fund is computed only once a week, and the possibility of misappropriation of its customers' fund by a securities company cannot be ruled out.

Therefore, with a view to strengthening the protection of investors, investor protection funds were established as legal entities under the Securities and Exchange Act (currently under the FIEA). To accomplish the above purpose, the investor protection fund (hereinafter referred to as the "fund") will (1) pay a specified amount of money (up to ¥10 million per customer to insure the repayment of his/her assets in the case of bankruptcy of a securities company and (2) make loans to securities companies to facilitate the prompt return of customer assets.

To enable the fund to provide such services, it is empowered by law to (1) perform any and all acts that are necessary to preserve customer assets held by securities companies, (2) become a trust manager of securities companies, and (3) create an "Investor Protection Fund" to secure the necessary funds and collect burden charges from its member companies. Members of the fund must be Financial Instruments Business Operators. More than one investor protection fund may be created, and securities companies (Type I Financial Instruments Business Operators) must participate in one of them.

12. Securities Operations of Financial Institutions

In 1948, banking institutions were prohibited, in principle, from conducting the securities business under Article 65, Paragraph 1 of the Securities and Exchange Act. As the Banking Act did not explicitly authorize banking institutions to conduct certain business related to public bonds or brokerage with written orders, which were provided for as exceptions to the above prohibi-

Table XII-21. Balance of Investment Trusts, by Seller (as of September 30, 2017)

(¥100 million)

	Securities companies		Banks (registered financial institutions)		Direct sales (investment trust management companies)		Total
Stock investment trusts	629,355	68.3%	283,868	30.8%	7,871	0.8%	921,095
Bond investment trusts	130,782	99.6%	441	0.34%	3	0.0%	131,227
Total	760,138	72.2%	284,310	27.0%	7,874	0.75%	1,052,322

Note: These figures are only for publicly offered investment trusts. Given the introduction of a negative interest policy by the Bank of Japan, early repayment of MMFs continued, and the balance has been zero since May 2017.

Source: Compiled from the statistics produced by The Investment Trusts Association, Japan.

Table XII-22. Banking and Securities Joint Branch Offices and Financial Instruments Intermediary Service of the Three Largest Financial Groups

Customer Introduction and Intermediary Services of Megabanks

Banks	Securities companies	Joint branch offices
Mizuho Bank, Ltd.	Mizuho Securities	Planet Booth 166 (March 2017)
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	Mitsubishi UFJ Morgan Stanley Securities	MUFG Plaza 26 (as of October 2017)
Sumitomo-Mitsui Banking Corporation	SMBC Nikko Securities	Customer introduction service (expanded to all branches from 2014)

Source: Compiled based on IR information, etc. of each company. The collaborative business between Sumitomo-Mitsui Banking Corporation and SMBC Friend Securities were transferred and integrated with SMBC Nikko in 2011.

Contribution from Intermediary Business to the Retail Operation of Mitsubishi UFJ Morgan Stanley Securities (FY2017/3)

(¥100 million)	Balance of assets under custody	Number of outstanding accounts (in thousands)	Sale of stock investment trusts	Individual investor government bonds	Sale of retail foreign bonds
Amount via intermediary	31,552 (28,329)	325 (313)	4,449 (5,430)	143 (49)	6,984 (5,979)
% of total	11.47% (11.06%)	24.73% (23.62%)	26.74% (26.16%)	5.14% (4.34%)	53.31% (49.19%)

Note: Balance of assets under custody and number of outstanding accounts figures are as of the end of March 2017. Percentages are of total amounts. Assets under custody pertain to domestic sales divisions (including financial institutions). Figures below in parentheses are for the fiscal term ended March 2016.

Source: Compiled from the databook provided for the FY2016 investor information meeting of the Mitsubishi UFJ Financial Group.

Table XII-23. Major Regional Bank-Affiliated Securities Companies

Name of company	Parent bank (investment ratio)	Year established (or the year of making it a subsidiary)	Name of company	Parent bank (investment ratio)	Year established (or the year of making it a subsidiary)
Shizugin TM Securities Co., Ltd.	The Shizuoka Bank Group (85.1%)	Dec. 2000	Fukuoka Securities Co., Ltd.	The Bank of Fukuoka (100%)	April 2012
Daishi Securities Co., Ltd. (former Niigata Securities Co., Ltd.)	The Daishi Bank, Ltd. (47.0%)	March 2006	Senshu Ikeda Tokai Tokyo Securities Co., Ltd.	The Senshu Ikeda Bank, Ltd. (60%)	January 2013
Hachijuni Securities Co., Ltd.	The Hachijuni Bank, Ltd. (100%)	April 2006	The San-In Godo Bank, Ltd.	Gogin Securities Co., Ltd. (100%)	August 2015
YM Securities Co., Ltd.	Yamaguchi Financial Group, Inc. (60%)	July 2007	Toho Securities Co., Ltd.	The Toho Bank, Ltd. (100%)	January 2016
The Joyo ecurities Co., Ltd.	Joyo Bank, Ltd.	November 2007	Gungin Securities Co., Ltd.	The Gunma Bank, Ltd. (100%)	July 2016
Hamagin Tokai Tokyo Securities Co., Ltd.	The Bank of Yokohama, Ltd. (51%)	July 2008	Hokuhoku Tokai Tokyo Securities Co., Ltd.	Hokuhoku Financial Group, Inc. (60%)	October 2016
Chugin Securities Co., Ltd.	The Chugoku Bank, Ltd. (81%)	June 2009	77 Securities Co., Ltd.	The 77 Bank, Ltd. (100%)	January 2017
Hyakugo Securi- ties Co., Ltd.	The Hyakugo Bank, Ltd. (100%)	August 2009	Kyogin Securities Co., Ltd.	Bank of Kyoto, Ltd.	March 2017
Nishi-Nippon City Tokai Tokyo Securities Co., Ltd.	Nishi-Nippon City Bank, Ltd. (60%)	May 2010	Okigin Securities Limited	The Bank of Okinawa, Ltd.	March 2017
Chibagin Securi- ties Co., Ltd.	The Chiba Bank, Ltd. (100%)	January 2011	Hirogin Securities Co., Ltd.	The Hiroshima Bank, Ltd.	June 2017
Iyogin Securities Co., Ltd.	The Iyo Bank, Ltd. (100%)	February 2012			

Source: Compiled based on websites of corporations and newspaper coverage.

tion (Article 65, Paragraph 2 of the Securities and Exchange Act), banking institutions (except for trust banks, which could pass their customer orders on to a securities company) did not conduct the securities business. Following the issuance of massive amounts of JGBs since 1975, the government enacted a new Banking Act in 1981, explicitly authorizing banking institutions to trade in public bonds, and it also correspondingly amended the Securities and Exchange Act. Accordingly, banking institutions started selling public bonds over the counter in 1983 and dealing in public bonds in 1984.

Subsequently, the following services have been added to types of securities businesses that banking institutions are allowed to provide: (1) brokerage for transactions in bond futures trading (1988); (2) trading, etc., and involvement in private placement of commercial papers (CPs), foreign certificates of deposit (CDs), beneficiary certificates of mortgage bond trusts, etc. (1992); (3) handling of OTC derivatives of securities and public offerings of beneficiary certificates of investment trusts (1998); and (4) securities agent business (2004; currently the financial instruments intermediary service). The registration system of securities companies and the system of authorizing certain securities businesses instituted in 1998 are also applied to banking institutions. And banking institutions that have registered under this system are called “registered financial institutions.” The revised FIEA of 2007 redefined the scope of the securities business prohibited in principle as securities-related businesses (section 1), no material changes to the provisions of law were made (with the only change being the number of the article: Article 65, Paragraph 1 and 2 became Article 33, Paragraph 1 and 2 of the FIEA).

On the other hand, the 1992 Institutional Reform Law authorized banks, securities companies, and trust banks to enter markets of one another through subsidiaries. Securities subsidiaries of banks were defined as “Specialized Securities Companies” (Article 16-2, Article 52-23 of the Banking Act) and the scope of their businesses was provided to include the “Securities-Related Business” (Article 28, Paragraph 8 of the FIEA), incidental businesses (items (i) through (viii) in Article 35, Paragraph 1 of the FIEA) and notified businesses (Article 35, Paragraph 2). At first, with a view to preventing potential adverse effects, the regulatory agency (1) restricted the scope of business that the securities subsidiaries of banks may conduct (i.e., the prohibition of stock brokerage, etc.) and (2) required the installation of a firewall between securities subsidiaries and their parents.

The restrictions on the scope of business have been lifted in stages, and the stock brokerage business was also deregulated in October 1999. Restrictions on the firewall were also eased in phases. In September 2002, the ban on opening banking and securities joint branch offices was lifted. And in March 2005, banks were allowed to introduce customers to securities companies as initial public offering (IPO) candidates (business-led service). In June 2009, the joint position regulations prohibiting officers and employees of securities companies and banks from working on both sides of the firewall were lifted, allowing them to share confidential information of corporate customers as long as the clients did not opt out of this arrangement. Recently, not only megabank groups but also regional banks have been entering into financial instruments intermediary service agreements with securities companies in developing joint banking and securities businesses through introducing customers, opening accounts and handling orders.

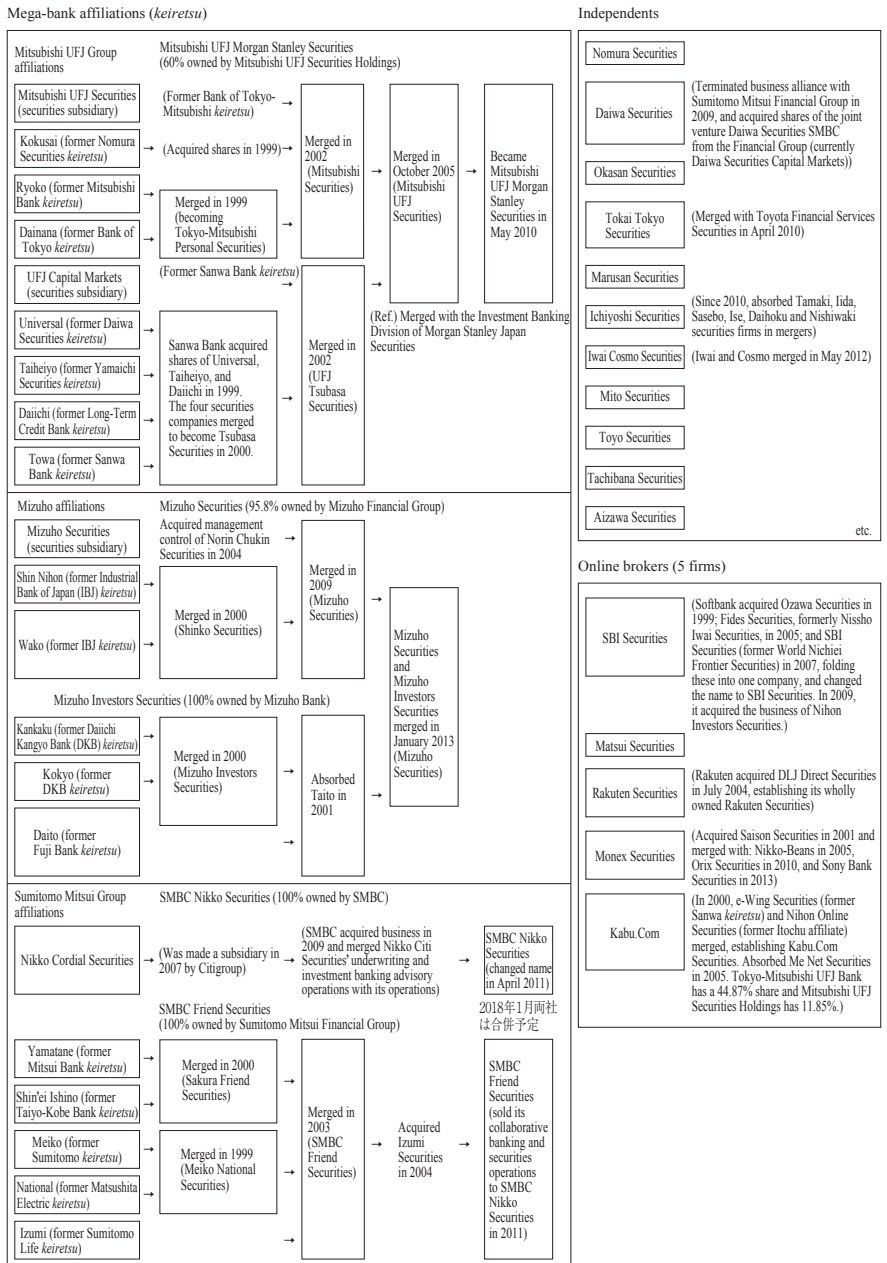
13. Competition Structure of the Securities Industry

In the securities industry of Japan, given that the Big Four securities companies had commanded the largest share in all segments of the market and had many small- and mid-sized securities companies as their affiliates (called “*keiretsu* companies”), the structure of competition used to be characterized as the “Big Four oligopoly.” However, the Big Four oligopoly broke down in the 1990s as (1) Yamaichi Securities went bankrupt in 1997; (2) Daiwa and Nikko split up their companies into two divisions in 1998—the wholesale division (providing underwriting, M&A advisory, proprietary trading and other services to corporate customers) and the retail division (providing individual investors with a brokerage service and offering the sale of investment trusts) (Daiwa later reintegrated the divisions); and (3) Nomura, Nikko (later changed name to Nikko Cordial), and Daiwa liquidated their holdings of shares in their affiliates. Following an accounting scandal, Nikko Cordial was acquired by Citigroup in 2007 and then was acquired by Sumitomo Mitsui Banking Corporation in October 2009 and became SMBC Nikko Securities.

The conventional business strategy of the former Big Four was to increase their shares in the brokerage market and win the mandate as the lead manager of equity financing by taking advantage of their share in brokerage. To achieve such goals, they sought to build a nationwide network of branches, hire a large number of employees loyal to their company, and lure many member companies of the stock exchanges under their umbrella. However, as such strategy entailed huge costs and risks, only a small number of securities companies could afford to pursue the strategy by providing full-line services (and by diversifying the sources of income thereby). In consequence, there came into existence only a few big and integrated securities companies that adopted the Japanese-style employment system with many affiliated brokers.

Their business strategies and management systems had played an important role during the rapid economic growth period as mechanisms nimbly supplying large amounts of capital to cash-starved industries of the country. As the years rolled on into the 1990s, however, the basic structure of the Japanese economy drastically changed, causing a mismatch between their business strategy and reality. The challenges facing today’s Japanese economy are to improve the effectiveness of the use of funds to reorient the structure of its industries and to provide for the aging of its population. The roles the securities industry is expected to play in the coming years are (1) to find and incubate emerging companies by promoting private equity investments; (2) to help legacy industries and incumbent businesses expedite their renovation and streamlining by advising them on the securitization of assets, M&A, and

Chart XII-4. Mega-Bank Securities Subsidiaries and Independent Securities Companies



other measures and by underwriting the securities they issue; and (3) to direct household savings into the securities markets by offering investment advice based on quality research and professional investment management services.

To accomplish this, it is necessary for securities companies to train and secure specialists by spinning off business divisions according to their specialties. What is more, the practice of maintaining an extensive network of affiliates no longer makes economic sense, and the shares of affiliates the parent securities companies hold will have to be liquidated. Meanwhile, banks and other corporations that are keen to enter the securities business have bought the shares that parent securities companies wanted to dispose of, and reorganization of the banking industry has resulted in the merger and consolidation of bank-affiliated brokers. Some brokers also have been bought out by the management (MBO). The *keiretsu* of brokers, therefore, is no longer rigid.

CHAPTER XIII

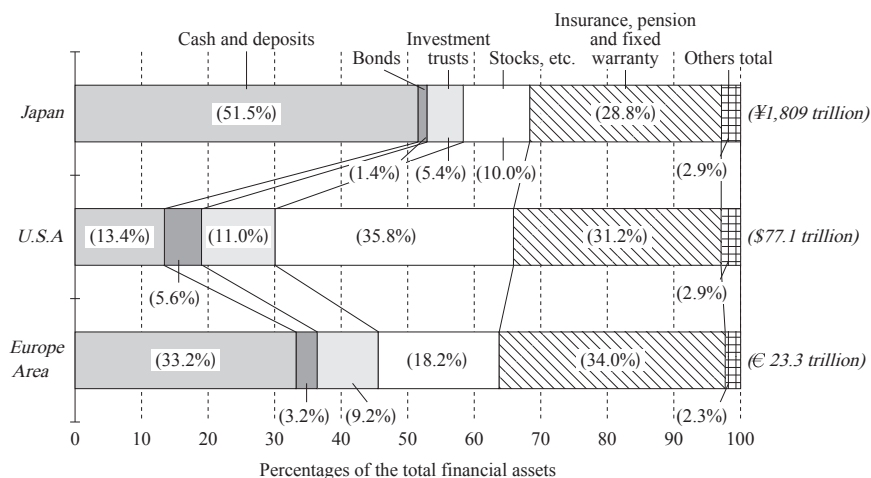
Asset Management Service

1. Management of Individual Financial Assets

According to a survey by the Bank of Japan, “Comparison of the Flow of Funds between Japan, the United States, and Europe,” at the end of March 2017 individuals in Japan had ¥1,809 trillion worth of financial assets. Of this amount, 51.5% was invested in cash and deposits and 16.8% in securities investments. Compared with the United States and Europe, Japan’s individual financial assets are heavily skewed toward cash and deposits more so than not only the U.S. but also the Euro area, and thinly invested in securities. In the 2016 survey by The Central Council for Financial Services Information, 45.7% of respondents said that they focused on “security” as their reason for selecting financial instruments, while 24.7% said “liquidity.” Only 17.5% of respondents said that they focused on “profitability.” Individual financial assets in Japan thus are mainly invested in low-risk bank deposits, with little preference for more profitable securities. Certainly during Japan’s era of deflation, the heavy investment in bank deposits probably turned out to have been the right call. With, however, the introduction of an inflation target in Japan and the implementation of massive quantitative easing to achieve that target, it is possible that the focus on safety carries with it the risk that the real value of cash will erode because of inflation.

Under these circumstances, the government introduced a preferential tax treatment investment system (NISA, a small-amount investment tax exemption scheme) in 2014 to promote the shift from “Savings to Investment.” Subsequently in 2016, the tax deductible line was expanded from ¥1 million to ¥1.2 million, and Junior NISA for the underaged was newly introduced. Additionally in 2018, the installment-type NISA was launched. Furthermore, in 2017, the coverage of iDeCo (individual-type defined-contribution pension) which had been limited to self-employed persons and white collar workers, etc. working for a company that does not have a corporate pension plan, was widened to also include government employees, full-time housewives (househusbands), and white collar workers who work for a company with a corporate pension plan.

Chart XIII-1. Composition of Household Assets (at March 31, 2017)



Note: Others total is the remains after deducting “Cash and deposits”, “Bonds”, “Investment trusts”, “Stocks, etc.”, and “Insurance, pension and fixed warranty” from total financial assets.

Source: Bank of Japan.

Table XIII-1. Points of Focus When Selecting Financial Products

<Households Holding Financial Assets>										(%)
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Profitability	16.5	15.8	16.6	15.8	18.7	16.9	14.7	16.7	17.6	17.5
High return	13.7	12.6	13.8	13.2	13.8	12.1	9.8	11.7	11.9	12.1
Anticipated price increase in the future	2.8	3.1	2.8	2.6	4.9	4.9	4.9	4.9	5.6	5.4
Safety	46.5	45.7	44.9	48.4	48.0	46.7	47.0	45.7	46.1	45.7
Principal is guaranteed	28.4	28.7	30.1	29.8	30.3	28.7	29.6	29.5	29.3	29.9
Financial institution handling the product is reliable and secure	18.1	17.0	14.8	18.6	17.6	18.0	17.4	16.3	16.8	15.8
Liquidity	28.1	29.4	30.9	28.5	23.7	24.7	25.0	25.1	23.1	24.7
Easy to convert to cash	6.3	6.7	5.3	4.5	4.6	5.3	5.9	6.0	6.0	6.7
Free to deposit/withdraw even in small amounts	21.7	22.7	25.7	24.0	19.0	19.4	19.1	19.1	17.2	18.0
Product content is easy to understand	2.4	2.0	2.0	1.8	2.2	2.5	2.5	3.1	3.2	2.4
Others	4.1	4.5	4.3	4.4	5.4	6.7	8.5	7.9	8.5	7.9
No response	2.4	2.5	1.3	1.0	2.0	2.4	2.2	1.5	1.7	1.9

Source: The Central Council for Financial Services Information.

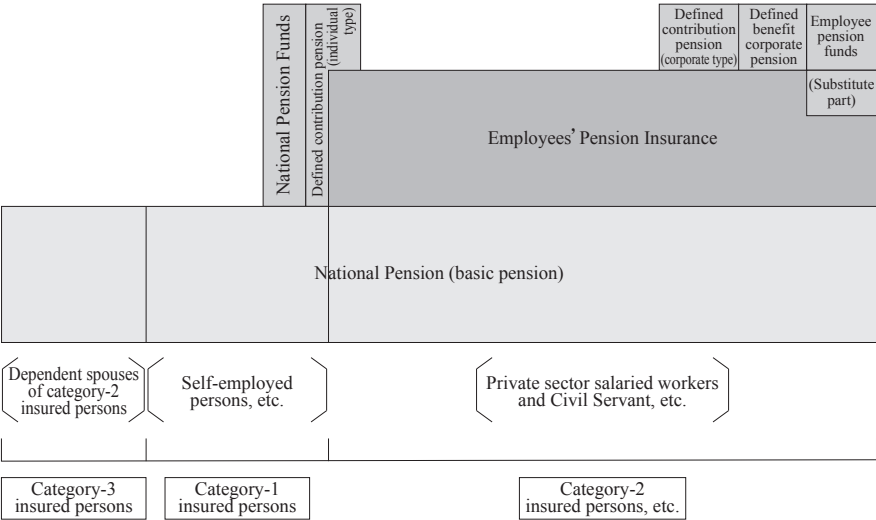
Asset management companies include trust banks, life insurance companies, and discretionary asset management companies that manage the pension and insurance reserves of individuals, i.e. people's security for the future. Investment trust management companies are also asset management companies, handling investment trusts for individual financial assets. Either indirectly or directly, asset management companies play an important role in financial asset formation by individuals in a society with low birth and mortality rates. These asset management companies also contribute to growth in corporate performances and to the sound development of the economy—and therefore society—through the following two functions. To begin with, they fulfill a role in achieving the efficient allocation of capital by supplying growth companies with capital through the market. Furthermore, they engage in stewardship activities to increase investment returns for customers and beneficiaries on a medium- to long-term basis, thereby contributing to enhancing corporate value and promoting sustainable growth of investee companies.

2. Pension Fund Management

Japan's pension plan system is a three-tier system consisting of (1) a foundational national pension (basic pension benefits) common to all citizens supplemented by (2) employee pension plans (employees' pension insurance system) for employees of private companies and government employees, and (3) corporate pension plans (employees' pension funds, defined-benefit corporate pension, and individual-type defined-contribution pension) for civil servants and private-sector salaried employees. Of these plans, the national pension and employee pension plans utilize a pay-as-you-go system that provides support shared among generations in the form of public pensions, while corporate pension plans use a funding system in the form of private pensions.

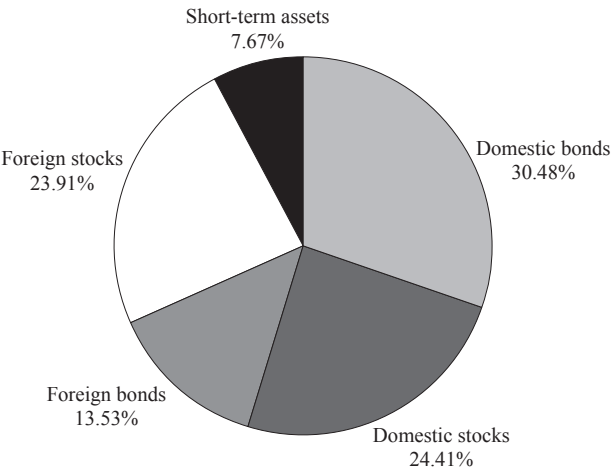
Employees' pension funds comprise a substitutional portion received from the public employees' pension insurance system and their own fund termed the "plus alpha" portion. In the past, the substitutional portion formed the core of these funds. Following the bursting of the economic bubble in Japan, however, difficult asset management conditions resulted in the substitutional portion placing a heavy burden on employees' pension funds. Companies one after the other reacted by either terminating the funds or returning the substitutional portion to the government and converting their funds to defined-benefit corporate pension, etc. At present, no new establishment is allowed. Defined-benefit corporate pension does not have this substitutional portion, allowing for flexible system planning with the agreement of the labor force. The individual-type defined-contribution pension plan differs from the previ-

Chart XIII-2. Structure of Pension System



Source: Ministry of Health, Labor and Welfare.

Chart XIII-3. GPIF's Investment Assets and Portfolio Allocation (total reserve funds)
(as of June 30, 2017)



Source: GPIF

ous pension system with fixed benefits (defined-benefit pension) in that the contributed premium of each individual is clearly segregated, with pension benefits being determined based on the total of a fixed premium and investment income.

The management of pension plans must be safe and efficient in the interest of protecting future benefits. With the exception, therefore, of a few large-scale pension funds that manage investments in-house, asset management of the pension fund is commissioned to outside investment companies. According to the 2015 fiscal year asset management survey by the Pension Fund Association, the allocation of corporate pension funds (employees' pension funds and defined-benefit corporate pension plans) to asset managers was trust banks, 50.5%; discretionary asset management companies, 25.8%; and life insurance companies, 23.7%. By composition of fund assets, domestic bonds accounted for 25.9%, domestic stocks for 11.7%, foreign bonds for 14.0%, foreign stocks for 13.4%, the general account of life insurance companies for 16.2%, and others for 11.6%.

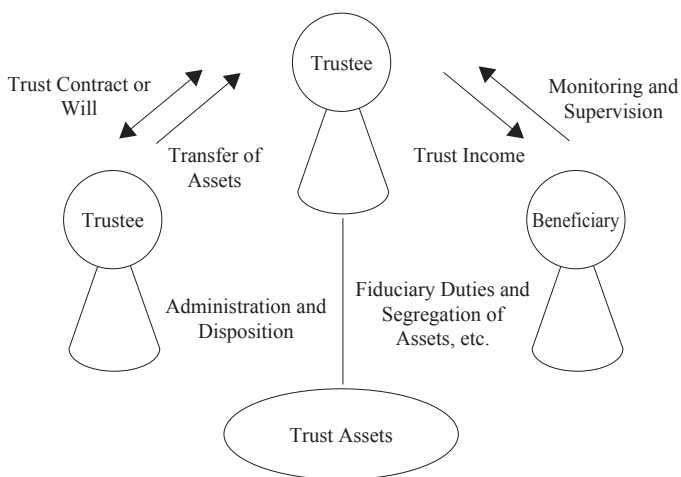
The cumulative reserves of the national pension and employee pension plans, which are public pensions, are administered and managed by the Government Pension Investment Fund (GPIF). By composition of fund assets of GPIF (as of the end of June 2017), domestic bonds accounted for 30.48%, domestic stocks for 24.41%, foreign bonds for 13.53%, and foreign stocks for 23.91%. Although previously pension funds were managed primarily by domestic bonds, steps are taken to promote diversified investment by investing also in stocks and foreign-denominated assets considering that the Japanese economy pulled out of deflation and domestic bond interest rates have declined to a low level.

3. Asset Management of Trust Banks

Entrustment occurs when (1) an entity (trustor) transfers its rights to property to an entity that can be depended on (trustee) based on a trust or some other legal agreement and when (2) the trustee is enabled to legally manage and dispose of the entrusted property on behalf of the trustor or a third party (beneficiary). In the case of the entrustment of a fund-based company pension plan trust, for example, the company's pension fund is the trustor and beneficiary, while the trust bank is the trustee. Because the system is premised on the dependability of the trustee, trust banks have a duty of due care of a prudent manager, duty of loyalty, and duty of segregated asset management.

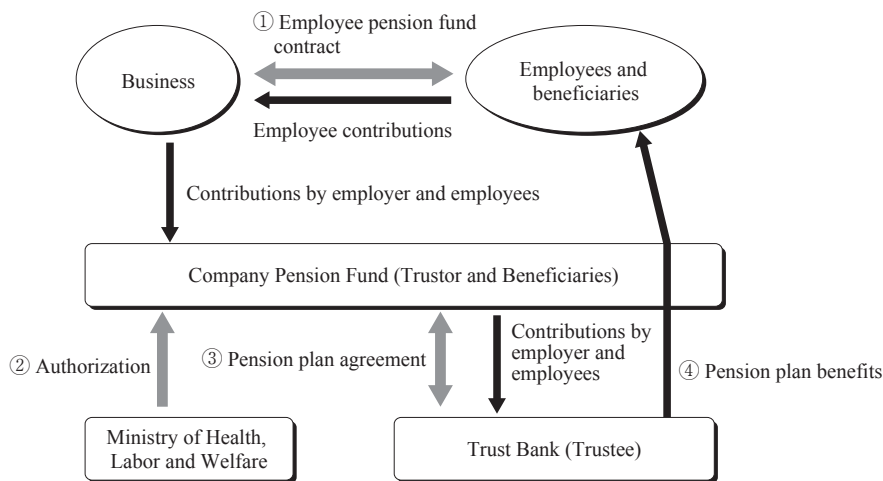
Trust banks can service pension funds in three different ways. They can manage the funds at their own discretion (designated asset management-type

Chart XIII-4. Trust Scheme



Source: Trust Companies Association of Japan.

Chart XIII-5. Fund-Type Company Pension Plan Trust Scheme



Source: Trust Companies Association of Japan.

trust) or not become involved in management without administering the assets (specified asset management-type trust), or be an intermediary trustee (general manager) representing the trustees and insurers in acting as the general manager for dealings with the trustor when the administration function is commissioned to multiple trust banks and insurance companies.

The two main features of trust bank operations are the high proportions of pooled asset management and passive investment policies in comparison with discretionary asset management companies. Pooled asset management combines the assets of multiple funds into one account. Compared with the independent management of assets, where the assets entrusted by each fund are kept separate and investment is made in specific securities, etc., this system enables even small-scale funds to diversify their investments. Another advantage is that the asset management fees and transaction costs are cheaper. On the other hand, with independent management it is easier to manage assets according to the needs of each fund involved than it is with pooled asset management.

Passive management is an investment method that aims to achieve a return in line with movement in a specified benchmark (index). In comparison with active management, where a manager makes trading decisions based on the investment value of individual securities with the aim of outperforming a benchmark, passive management has the advantage of keeping trading turnover costs low as well as curtailing management fees because detailed research and analysis is not required for individual securities. Moreover, in contrast with discretionary asset management companies, trust banks' businesses encompass not only asset management but also fund administration. With the relatively large assets under management and the amount of business involved, trust banks have two synergies of the economies of scale and the economies of scope. These benefits combine to provide an advantage to the client in terms of lower asset management fees. With passive management, on the other hand, clients can only expect benchmark asset performance. And there is such criticism that passive management gets a free ride on active management because of its little function of capital allocation.

4. Asset Management of Life Insurance Companies

Life insurance policyholders pay a premium based on the likelihood of their living or dying. There are generally two types of life insurance: mortality insurance that insures a policyholder against death and annuities that provide for their livelihood in old age. Life insurance companies (insurers) accumulate the insurance premiums received from policyholders into a liability reserve to provide for future claim distributions and invest them. There are two

Table XIII-2. Asset Composition

(%)

	Cash and deposits	Call loans	Money trusts	Securities	Loans	Tangible fixed assets	Others	Total assets
FY2011	1.1	0.8	0.6	78.8	12.9	2.0	3.8	100.0
2012	1.0	0.8	0.6	80.7	11.7	1.9	3.4	100.0
2013	1.3	0.8	0.7	81.3	10.9	1.8	3.3	100.0
2014	1.5	1.0	0.9	81.5	10.0	1.7	3.3	100.0
2015	2.0	0.3	1.0	81.8	9.5	1.7	3.5	100.0

Figures excluding Japan Post Insurance Co., Ltd.

2011	1.0	0.8	0.8	78.4	12.1	2.8	4.1	100.0
2012	1.1	1.0	0.7	80.8	10.8	2.5	3.0	100.0
2013	1.0	0.9	0.7	81.8	10.3	2.4	2.8	100.0
2014	1.2	1.1	0.7	82.6	9.5	2.2	2.7	100.0
2015	2.0	0.3	0.7	82.9	9.1	2.1	2.8	100.0

Source: The Life Insurance Association of Japan.

Table XIII-3. Composition of Securities under Management

(100 millions of yen, %)

	Government securities		Municipal bonds		Corporate bonds		Stocks		Foreign securities		Other securities		Total
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount
FY2011	1,412,757	54.9	131,630	5.1	253,429	9.8	147,444	5.7	469,267	18.2	161,074	6.3	2,575,603
2012	1,487,692	53.5	139,346	5.0	251,551	9.0	167,256	6.0	559,864	20.1	176,735	6.4	2,782,448
2013	1,498,157	52.6	140,089	4.9	248,959	8.7	180,299	6.3	614,509	21.6	168,303	5.9	2,850,317
2014	1,487,617	49.7	138,686	4.6	248,553	8.3	226,979	7.6	732,804	24.5	159,654	5.3	2,994,295
2015	1,485,684	49.4	135,178	4.5	253,634	8.4	198,130	6.6	786,531	26.2	146,074	4.9	3,005,235

Figures excluding Japan Post Insurance Co., Ltd.

2011	813,135	44.4	53,851	2.9	191,154	10.4	147,434	8.1	463,081	25.3	161,074	8.8	1,829,732
2012	922,966	44.9	52,361	2.5	186,713	9.1	167,246	8.1	550,842	26.8	176,735	8.6	2,056,866
2013	972,928	45.1	48,351	2.2	184,540	8.6	180,289	8.4	602,114	27.9	168,303	7.8	2,156,527
2014	1,006,752	43.2	43,127	1.8	182,028	7.8	226,969	9.7	712,990	30.6	159,654	6.8	2,331,523
2015	1,043,898	44.1	41,123	1.7	191,265	8.1	198,120	8.4	749,643	31.6	145,073	6.1	2,369,126

Source: The Life Insurance Association of Japan.

types of accounts used to manage the investment of insurance premiums. The general account guarantees the policyholder a certain fixed amount of benefits regardless of how the general account performs, while the special account policies pay out benefits that vary based on asset management performance.

Under a general account life insurance policy, the insurer promises to pay a certain amount of benefits, and the policyholder agrees to pay a premium that is commensurate with the promised benefit. The premium is computed on the premise of an assumed basic rate comprising such factors as assumed mortality rate, assumed ratio of expenses, and assumed rate of return. Since the assumed basic rate is set conservatively, a positive difference can occur between the assumed and actual rate. When this happens, a portion of the profit is returned to policyholders as a dividend.

According to the 2016 issue of *Trends in the Life Insurance Business*, published by the Life Insurance Association of Japan, of the total assets under management by life insurance companies at the end of fiscal 2015, securities accounted for 81.8%, while loans accounted for 9.5%. The recent trend has been an increase in the amount of securities coupled with a decrease in loan holdings. Looking at the breakdown of securities, Japanese government bonds made up the greatest portion (49.4%), followed by foreign securities (26.2%, of which bonds accounted for 24.0% and equities 2.2%); Japanese corporate bonds (8.4%); Japanese equities (6.6%); and Japanese municipal bonds (4.5%).

In recent years, insurance companies have come to focus more on asset liability management (ALM) because of the introduction of mark-to-market accounting and stricter regulations on solvency margins. Liability reserves, which account for most of insurance company liabilities, are superlong liabilities with a duration (average maturity) of more than 10 years. As such, in their asset management strategies, the insurance companies have increasingly favored investment in 20-year and other superlong Japanese government bonds. On the other hand, insurance companies also are cautiously investing in stocks with a risk of high price volatility and foreign bonds which carry an exchange rate risk. In addition, there is a trend toward using currency hedges to avoid currency risk when investing in foreign securities.

Targeting group pension plans, special account insurance offers several options. In a policy with a Class 1 rider, the assets of multiple customers are managed as a pool based on the investment policies of the life insurance company. In a Class 2 rider policy, the assets of each customer in the group are managed separately using investment policies that reflect the wishes of the individual customer. Within a Class 1 rider policy, there also are balanced-type consolidated accounts for which the life insurer determines the allocation among asset classes and separate designed investment accounts that reflect individual customer preferences in asset allocation.

5. Asset Management of Discretionary Asset Management Companies

Discretionary asset management companies manage the assets of customers based on a discretionary investment contract that gives those companies the necessary authority to make investment decisions and investments on behalf of their customers. Among the major customers of these companies are institutional investors, such as public pensions, pension funds, financial companies, business companies, and sovereign wealth funds. Discretionary management companies can be considered the business sector where liberalization and internationalization have progressed the most, even in the financial industry, which has low barriers to entry for non-financial or foreign companies. As a category for investment specialists, the asset management company category includes investment trust management companies and fund managers that sell units in group investment schemes, such as venture capital funds, as well as discretionary management companies.

The Japan Investment Advisers Association is a self-regulatory body for the discretionary asset management industry. It is designed to protect investors by ensuring the fair and smooth operation of members' investment management business. It also contributes to the sound development of the investment management business and related matters. The investment management industry's business and other activities contribute significantly to the capital market. In consideration of this important role, the association also works to improve corporate governance by collecting and announcing information about initiatives taken by members of the association in adopting the Stewardship Code, by forming study groups on the Stewardship Code, and by carrying out discussions and research.

A special feature of discretionary asset management companies in comparison with trust banks is the high proportion of active investment and customized asset management services that closely reflect the wishes of customers. When commissioned to handle the management of assets, they leave the administration side of the business to trust banks and other financial institutions. Reacting to the pension plan fraud scandal in 2012 and other incidents, trust banks are expanding and reinforcing their monitoring systems by strengthening their independent party checking function and other measures.

Allocation of the assets of customers is done based on investment guidelines and other agreements determined through discussions with pension funds and additional customers. Trends in recent years show that along with the diversification of the investment needs of pension funds, these funds are not limited to such traditional investment instruments as stocks and bonds but also involve investments in the stocks and bonds of high-growth emerging countries and alternative investments that target absolute rather than rela-

Chart XIII-6. Investment of Pension Assets by Discretionary Asset Management Company

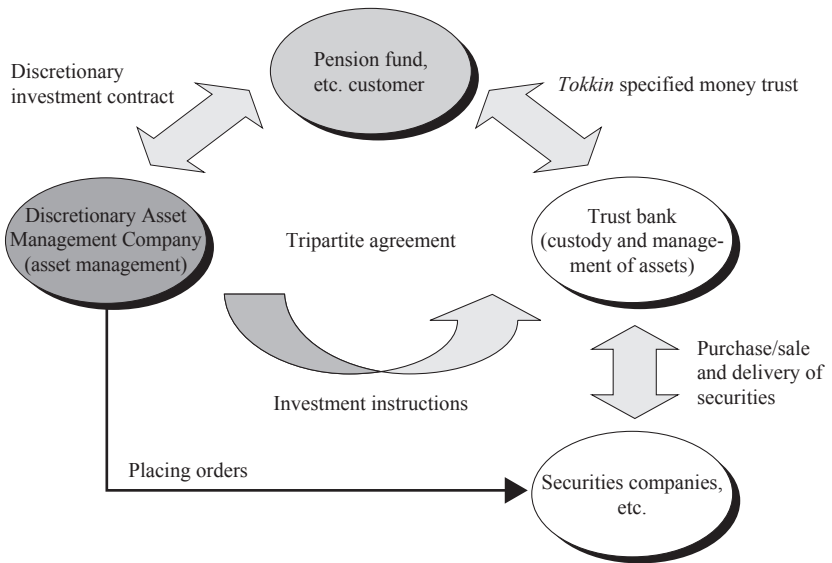


Table XIII-4. Scheme comparison

	Traditional discretionary investment contract	Real estate private placement fund	Wrap Account
Customer	Institutional investors	Fund	Individual investors
Investment target	Traditional securities	Real estate trust beneficiary rights	Traditional securities
Managing entity	Specialized management company	Specialized management company	Company concurrently engaged in securities business

tive returns, such as real-estate-related securities and hedge funds.

In addition to the aforesaid traditional discretionary investment services for institutional investors as customers, schemes for real estate private placement funds as customers as well as the wrap accounts provided by securities companies and trust banks for individual investors have also been attracting attention in the last few years.

6. Asset Management of Investment Trusts

Investment trusts are a type of collective investment scheme based on pooling small investments from many investors and have three significant features. First, they enable the diversification of small investments. Using investment trusts allows individual investors to lower their risk through diversification just the same as institutional investors even with small investments. For example, investment in an investment trust fund that has diversified its investments into no less than one thousand stocks and in 40 or more countries starts from about ¥10,000. The second feature is that investment trusts are managed by professionals. Building the optimum investment portfolio based on macroeconomic analysis as well as financial trends and stock price analysis requires advanced knowledge, analytic capabilities, and investment technology. Through investment trusts, even individual investors can benefit from the skills of professional fund managers. The third feature of investment trusts is transparency. The mark-to-market net asset value of these investment trust funds is published on a daily basis, and Japanese laws have beefed up disclosure requirements.

An investment trust with instructions from trustors is representative of schemes adopted in Japan. Assets collected from investors (beneficiaries) through subscriptions by distributing companies, such as securities companies and registered financial institutions, are managed by a trustor (investment trust management companies) and held in safekeeping and administered by a trustee (trust banks).

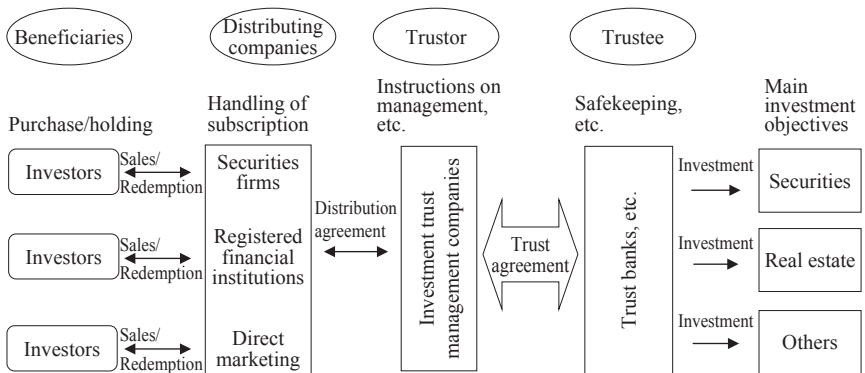
When the investment trust system was first set up, government regulators only approved investments in Japanese stocks. However, over the 60-year history of the industry the investment regulations have gradually been liberalized, and today it is possible to create a truly wide range of investment instruments based on the products available. For example, by including short-term financial instruments, they can structure investment trusts, such as money reserve funds (MRFs), that mimic bank deposits. Furthermore, since the approval of investment in real estate and commodities, individual investors can take a stake in office buildings, gold, oil, and other investments through investment trusts.

Entry into the investment trust market has also been liberalized from a limitation to only approved companies associated with major securities companies to a registration system that requires only that companies meet certain conditions. As a result, the industry has grown from only about 10 companies at one time to over 100 investment trust management companies. Moreover, with the lifting of the bans on outsourcing asset management and on investing in a fund of funds, investment trusts can also indirectly offer their cus-

Table XIII-5. Trends in the Liberalization of Investment Trust Regulations in Japan

1951	Securities companies begin investment trust management business
1959	Investment trust management companies made independent of securities companies
1961	Ban on inclusion of public bonds lifted (Bond investment trusts established)
1970	Ban on inclusion of foreign securities lifted
1978	Ban on use of forward exchange contracts lifted
1986	Ban on inclusion of OTC-registered stocks lifted
1987	Ban on use of derivatives for hedging purposes lifted
1990	Foreign-affiliated investment management companies enter market
1993	Bank-affiliated investment management companies enter market
1995	Ban on use of derivatives for other than hedging purposes lifted (Bull/Bear funds established) Exchange traded funds (ETFs) introduced Ban on conducting both discretionary asset management and commissioned investment trust management businesses lifted
1998	Financial System Reform Law passed (Japanese Big Bank) Deregulation converts investment trust management companies from licensing to approval system Ban on outsourcing asset management lifted Ban on investment trusts being sold through banks on an agency basis lifted
1999	Ban on fund of funds (FoFs) lifted
2001	Real estate investment trusts (REITs) introduced
2007	Further deregulation converts investment trust management companies from approval to registration system
2008	Ban on inclusion of commodities lifted

Chart XIII-7. The Structure of Investment Trusts with Instructions from Trustors



Source: The Investment Trusts Association, Japan.

tomers access to the investment services of foreign asset management companies. Although sales were restricted to securities companies previously, sales access points have been expanded through direct distribution by investment management companies and by agency sales by banks and other registered financial institutions.

7. Stewardship Code

Given the Cabinet's approval of the Japan Revitalization Strategy in June 2013, the Principles for Responsible Institutional Investors (Japan's Stewardship Code) formulated by the Council of Experts Concerning the Japanese Version of the Stewardship Code (secretariat placed in the Financial Services Agency (FSA)) were announced in February 2014, and then in May 2017, a revised version was released.

The Stewardship Code defines the principles considered to be helpful for institutional investors in fulfilling their stewardship responsibilities of enhancing the medium- to long-term investment return for their clients and beneficiaries by increasing the investee companies' corporate value and sustainable growth through conducting "constructive dialog" based on in-depth knowledge of the companies and their business environment. The Stewardship Code and the Corporate Governance Code serve as two wheels of a cart so-to-speak, and in expectation that broad penetration and implementation of these two Codes will contribute to realizing effective corporate governance in Japan, over 200 institutional investors have also adopted the Stewardship Code. The Stewardship Code is not a law or a legally binding regulation. It also adopts a principles-based approach instead of a rule-based approach. The Stewardship Code calls for the following three key actions to be taken by institutional investors toward investee companies: (1) monitoring (Principle 3); (2) engagement (Principle 4); and (3) exercise of voting rights (Principle 5).

First, according to the Code, (1) institutional investors should monitor investee companies so that institutional investors can fulfill their stewardship responsibilities with an orientation towards the sustainable growth of the companies. Monitoring should be performed continuously and effectively, and should cover a variety of factors, including non-financial matters. Next, (2) engagement refers to having "purposeful dialog" with investee companies in order to arrive at an understanding in common with investee companies and work to solve problems. Institutional investors are expected to have a clear policy in advance on how they design dialog with investee companies. Further, (3) institutional investors should seek to exercise voting rights on all shares held. In exercising their voting rights, they are expected to decide on

Table XIII-6. The Principles of the Stewardship Code

So as to promote sustainable growth of the investee company and enhance the medium- and long-term investment return of clients and beneficiaries,

1. Institutional investors should have a clear policy on how they fulfill their stewardship responsibilities, and publicly disclose it.
2. Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.
3. Institutional investors should monitor investee companies so that they can appropriately fulfill their stewardship responsibilities with an orientation towards the sustainable growth of the companies.
4. Institutional investors should seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with investee companies.
5. Institutional investors should have a clear policy on voting rights and disclosure of voting activity. The policy on voting rights should not be comprised only of a mechanical checklist; it should be designed to contribute to the sustainable growth of investee companies.
6. Institutional investors in principle should report periodically on how they fulfill their stewardship responsibilities, including their voting responsibilities, to their clients and beneficiaries.
7. To contribute positively to the sustainable growth of investee companies, institutional investors should have in-depth knowledge of the investee companies and their business environment and skills and resources needed to appropriately engage with the companies and make proper judgments in fulfilling their stewardship activities.

the vote in light of the results of the monitoring of investee companies and the contents of dialog with them. Institutional investors should also have a clear policy on voting rights and publicly disclose it.

CHAPTER XIV

Securities Taxation

1. Transitions in Securities Taxation (1)

Basically, the income tax system of Japan is based on comprehensive taxation (taxation on the total income). It traces its origin to a recommendation made soon after the war by the Shoup Recommendation on Japanese Taxation. Under the Shoup taxation system enforced in 1950, not just interest and dividends but also capital gains from sales of securities (the whole amount of a capital loss from the sale of securities was deductible) were subject to comprehensive taxation. After the end of the Allied military occupation, however, the Japanese government authorized separate taxation on interest and exempted from tax, in principle, capital gains from the sale of securities primarily from a policy standpoint to encourage accumulation of capital—with the result that the ideal of comprehensive taxation on income has disintegrated rapidly. And it was a sweeping reform of the taxation system carried out in 1987–1989 that helped the basic framework of the present income tax system take shape. At that time, the structure of income taxation was changed from one consisting of 15 brackets (10.5%–70%) to a flat one consisting of five brackets (10%–50%), and the financial income taxation system was overhauled thoroughly, including the uniform separate withholding taxation on interest income; the abolition of the tax-exempt savings system, in principle; and separate taxation, in principle, on capital gains from the sale of securities. The structure of income tax rates was amended to 4 brackets (10%–37%) in the fiscal 1999 tax reform and to 6 brackets (5%–40%) in the fiscal 2006 tax reform. In the fiscal 2013 tax reform, from the perspective of correcting income disparity and reviving the income redistribution function, starting with income tax for 2015, the rate for taxable income in excess of ¥40 million was set at 45%. Based on the fiscal 2016 tax reform, the basic corporate income tax rate was reduced to 23.4% from the existing 23.9% in FY2016, and will be further reduced to 23.2% in FY2018. As a result, the tax rate for national and local combined (the effective corporate tax rate) will be 29.74% in FY2018.

Looking at major trends in Japan's securities taxation system during the

Table XIV-1. Securities Taxation Evolution Timeline (1949–2002)

Year	Major amendments	Income tax brackets
1949	Shoup recommendation	
1950	A comprehensive taxation of interest, dividends, and capital gains from the sale of securities is enforced.	8 brackets (20%–55%)
1951	The optional separate withholding tax (50%) on interest is revived.	
1952	The withholding tax on dividends (20%) is revived.	
1953	Securities capital gains are exempted from income tax, in principle. The securities transaction tax is instituted (0.15% of the value of stock transaction). A uniform separate withholding tax on interest (10%) is instituted.	11 brackets (15%–65%)
1954	The withholding tax on dividends is reduced (from 20% to 15%).	
1955	Interest is exempted from income tax. The withholding tax on dividends is lowered (from 15% to 10%).	
1957	The separate withholding tax only on interest on short-term savings is revived (10%).	13 brackets (10%–70%)
1959	The separate withholding tax on interest on long-term savings is revived (10%).	
1961	Securities capital gains tax is levied on certain large-lot transactions.	
1962		15 brackets (8%–75%)
1963	The withholding tax rate on interest and dividends is lowered (from 10% to 5%).	
1965	The withholding tax rate on interest and dividends is raised (from 5% to 10%). The system of not requiring declaration and the optional separate withholding tax on dividends (15%) are introduced.	
1967	The withholding tax on interest and dividends is raised (from 10% to 15%). The optional withholding tax on dividends is raised (from 15% to 20%).	
1969		16 brackets (10%–75%)
1970		19 brackets (10%–75%)
1971	The optional separate withholding tax on interest (20%) is revived.	
1973	The optional withholding tax on interest and dividends is raised (from 20% to 25%). The securities transaction tax is raised (from 0.15% to 0.3%).	(The taxable income applicable to tax rate brackets is raised in 1971 and again in 1974.)
1976	The optional withholding tax on interest and dividends is raised (from 25% to 30%).	
1978	The withholding tax rate on interest and dividends is raised (from 15% to 20%). The optional withholding tax rate on interest and dividends is raised (from 30% to 35%). The securities transaction tax is raised (from 0.3% to 0.45% for stocks, etc.).	
1981	The securities transaction tax is raised (from 0.45% to 0.55%).	
1984		15 brackets (10.5%–70%)
1987	A sweeping tax reform	12 brackets (10.5%–60%)
1988	- The <i>maruyu</i> system is abolished, in principle.	
1989	- Uniform separate withholding tax on interest (20%) (products similar to financial instruments are also subject to the uniform separate withholding tax). - Securities capital gains are taxed, in principle (introduction of a separate withholding tax of 1% of the stock transaction value). - The securities transaction tax is lowered (from 0.55% to 0.3%).	5 brackets (10%–50%)
1995		(In 1995, the taxable income applicable to tax rate brackets is raised.)
1996	Securities capital gains tax is normalized (from 5% of deemed capital gains to 5.25%). The securities transaction tax is lowered (from 0.3% to 0.12%).	
1998	The securities transaction tax is lowered (from 0.12% to 0.06%).	
1999	The securities transaction tax is abolished.	
2001	A tax exemption system is launched for small-amount capital gains from the sale of stocks held long term (abolished after the 2003 tax system reform). An emergency investment tax break is established.	4 brackets (10%–37%)
2002	The special account system is established (implemented January 2003).	

late 1990s and early 2000s, the government built taxation systems for stock options, specific-purpose companies, and corporation type investment trusts in 1998. Effective April 1999, it abolished the securities transaction tax and the exchange tax (imposed on futures and options trading), which had long been issues of concern. Further measures followed with the enhancement of the Angels Taxation System in 2000 and the introduction of the tax-exemption system for profits on small sales amounts of stocks being held for the long term (a ¥1 million special tax exemption on stocks, etc., held for one year or more) and an emergency investment tax break (a tax exemption on up to ¥10 million of principal) in 2001. The establishment of the special account system was included in the tax revisions for fiscal 2002 and launched on January 1, 2003. During the same period, the government reorganized its small-amount tax-exemption system for small-sum savings of the elderly, etc. (*Maruyu* savings system for the elderly, etc.), converting it into a small-amount, tax-exemption system for persons with disabilities, etc.

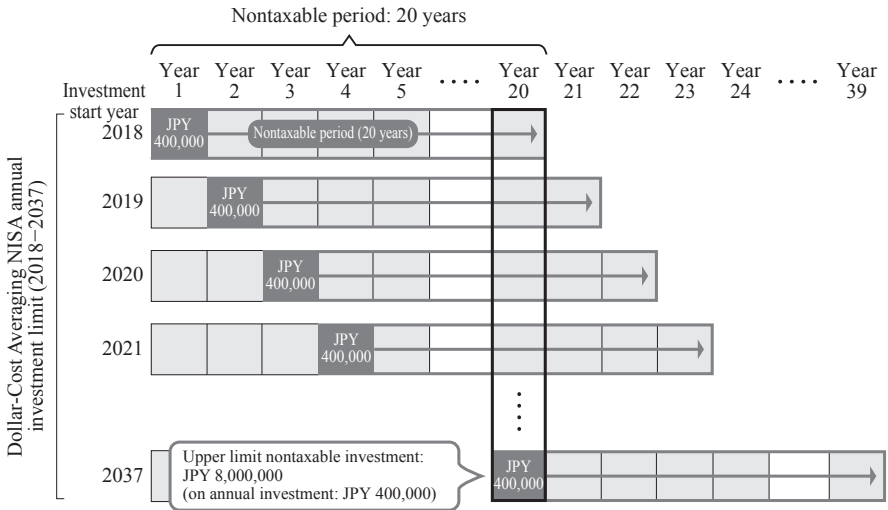
2. Transitions in Securities Taxation (2)

Since 2003, the reforms in the securities taxation system have focused mainly on revisions in the preferential tax system for dividends and capital gains on listed stocks, etc., expanding the scope of offsetting losses against gains, and revisions concerning the systems of non-taxables.

Table XIV-2. Securities Taxation Evolution Timeline (Since 2003)

Year	Major amendments	Income tax brackets
2003	Non-declaration system is introduced for dividends and capital gains of listed stocks, etc. The tax exemption system for small-amount capital gains from the sale of stocks held long term is abolished	↓ 6 brackets (5%–40%)
2004	Preferential tax rate on dividends and capital gains from publicly offered stock investment trusts is introduced Tax rate on capital gains is reduced from the sale of unlisted stock (from 26% to 20%).	
2007	The expiration date of application for a preferential tax rate is extended for a year for dividends and capital gains of listed stocks, etc.	↓ 7 brackets (5%–45%)
2009	Mechanism is introduced enabling netting of dividends and capital gains and losses from listed stocks, etc. Preferential tax rate on dividends and capital gains of listed stocks, etc. is extended for three more years	
2011	Preferential tax rate on dividends and capital gains of listed stocks, etc. is extended for two more years	↓
2014	Nippon Individual Savings Account (NISA) is introduced	
2015		
2016	Tax system for bonds, etc. is changed and scope of profit and loss netting expanded Junior NISA is introduced	
2017	Installment-type NISA is introduced (from 2018)	

Chart XIV-1. Conceptual image of Dollar-Cost Averaging NISA



Source: Website of the Financial Services Agency (FSA)

In terms of the revisions relating to the preferential tax rate, in the fiscal 2003 tax reform, the government introduced a non-declaration requirement system that imposed only a fixed withholding tax of 20% (15% in income tax and 5% in local inhabitant tax) on dividends and capital gains from listed stocks, etc., and distributions of gains from publicly offered stock investment trusts. At the same time, the government introduced a preferential tax rate of 10% on a limited-time basis. In the fiscal 2004 tax reform, the government extended this preferential tax rate to cover taxable gains from publicly offered stock investment trusts. Then in the fiscal 2007 tax reform, the government carried over the preferential tax treatment for dividends and capital gains from listed stocks etc., for another year. Furthermore, in the fiscal 2008 reform, with a view to abolishing the preferential tax rate at the end of 2008 and to transition smoothly into the new system, the government implemented a special measure of applying the preferential tax rate on capital gains of no more than ¥5 million and dividends of no more than ¥1 million for two years in 2009 and 2010. However, the fiscal 2009 tax reform extended the preferential tax rate to December 31, 2011, and the tax reform for fiscal 2011 extended it another two years. To help fund the restoration of the areas stricken by the Great East Japan Earthquake, a special income tax for reconstruction is being levied from 2013 to 2037.

Looking at the trend in the scope of allowing netting of losses against

gains, the fiscal 2003 tax reform made it possible for investors to offset losses on redemptions (termination of agreement) of publicly offered stock investment trusts on equities, etc., for the year. The fiscal 2004 tax reform added a tax deduction carryforward system (three years) for capital losses on publicly offered stock investment trusts. To reduce the risk of investing in equities for individual investors, the fiscal 2008 tax reform also added a mechanism allowing investors to offset capital losses on listed stocks, etc., against dividends beginning in 2009. Although the application of this mechanism was limited to investors who chose to separately declare their dividend income from listed stocks, etc. in 2009, it became possible to also do so using an income tax withholding account from 2010. Furthermore, the fiscal 2013 tax reform enforced changes to the taxation method for bonds, etc., making it possible to offset income against losses for interest and capital gains on specified bonds, etc., and income from listed stocks starting in 2016.

The revision concerning a tax exemption system introduced NISA in 2014, followed by the introduction of Junior NISA in 2016. Further, a Dollar-Cost Averaging NISA will be introduced in 2018 (see section 8). Meanwhile, the scope of persons eligible to apply for individual-type defined-contribution pension plan has been widened from 2017 (see section 11).

3. Taxation of Interest

Under the fiscal 2013 tax reform, changes were made to the taxation system regarding interest income to go into effect in 2016. The outline of the current system is as follows. The method of separate taxation on the basis of self-assessment or non-declaration is applied for interest on specified bonds and profits distributed by publicly offered bond investment trusts and investment trusts managing publicly offered bonds, etc. after paying a 20% withholding tax (20.315% including the special income tax for reconstruction). Specified bonds are certain bonds and bond investment trusts, such as government bonds, local government bonds, foreign government bonds, publicly offered bonds, and listed bonds. Interest on deposits and savings, and bonds other than specified bonds and profits distributed by jointly invested trust accounts and privately placed bond investment trusts are treated, in principle, as interest income, and is subject to a withholding tax at a rate of 20% (20.315% including the special income tax for reconstruction) separately from other income.

Discount bonds may be categorized into two types from the perspective of taxation on redemption gain. One is subject to an 18% separate withholding tax (18.378% including the special income tax for reconstruction) on the discount portion (redemption gain) at the time of issuance. Note, however, that

Table XIV-3. Interest Taxation System

Classification	Outline
<ul style="list-style-type: none"> Interest on specified bonds Profits distributed by publicly offered bond investment trusts and investment trusts managing publicly offered bonds, etc. 	Separate taxation on the basis of self-assessment or no declaration necessary (20% withholding tax including 5% inhabitant tax)
<ul style="list-style-type: none"> Interest on deposits and savings Interest on bonds other than specified bonds (Note 1) Profits distributed by jointly managed investment trusts and privately placed bond investment trusts 	Separate withholding tax (20% including 5% inhabitant tax)
Tax-exempt savings system	<ul style="list-style-type: none"> Tax-exempt interest income earned from a small-amount deposit by persons with disabilities, etc. (on principal of up to ¥3.5 million) Tax-exempt interest income earned from a small-amount investment in public bonds by persons with disabilities, etc. (on principal of up to ¥3.5 million) Tax-exempt system for the workers' property accumulation savings for house construction plan and the workers' property accumulation savings plan (on principal of up to ¥5.5 million)

Note: 1. Excluding interest on corporate bonds issued by a family company the payment of which is received by a corporate executive, etc. of the family company.
2. Special income tax for reconstruction is levied from 2013 to 2037.

discount bonds issued by the Trans-Tokyo Bay Highway Corporation and the Organization for Promoting Urban Development are subject to a 16% separate withholding tax (16.336% including the special income tax for reconstruction). The other type of discount bonds is basically subject to separate taxation on the basis of self-assessment at the time of redemption.

Tax-exempt systems of interest income include the tax-exempt small-amount savings system for persons with disabilities, etc. and the tax-exempt system of interest income for workers' property accumulation savings plan (tax-exempt system for property accumulation).

The tax-exempt small-amount savings system for persons with disabilities includes a tax-exempt system for interest income on small-sum savings for persons with disabilities (*Maruyu* savings for persons with disabilities, etc.) and one for interest income on small-amount public bonds for persons with disabilities (special *Maruyu* for persons with disabilities, etc.). Both of these systems have an upper limit of ¥3.5 million for tax-exempt principal, making earnings on a total of up to ¥7 million in principal tax free when both types of systems are used. The government abolished the previously available tax-

Table XIV-4. The Status of Taxation on Interest Income, Etc. (2015)

(millions of yen)

Classification	Amount paid		Withholding tax amount
		Taxable amount	
Public bonds	10,188,814	240,952	36,879
Corporate bonds	3,326,196	781,598	118,811
Deposits (Banks)	691,557	572,265	87,029
Deposits (Others)	608,275	360,126	54,859
Jointly invested trusts	22,902	13,770	2,084
Bond investment trusts	86,306	80,984	12,201
Redemption gains from discount bonds	28,002	28,002	5,141
Others	667,682	605,882	113,165
Total	15,619,734	2,683,577	430,169

Notes: 1. Taxable amount includes not only that paid to individuals but also that to corporations.
2. As fractions were rounded to the nearest whole number, the figures may not add up to the actual total amounts.

Source: Compiled based on the data available on the website of the National Tax Agency of Japan.

exempt system for interest income on postal savings for persons with disabilities, etc., after the privatization of postal services. Now qualified persons with disabilities include persons with a physical disability certificate, wives of insured persons receiving survivors' basic pension benefits, and recipients of widow's pension benefits.

The tax-system for property accumulation includes the workers' property accumulation savings for house construction plan and the workers' property accumulation savings plan. These savings are designed to encourage workers below 55 years of age to buy houses and stabilize their retirement lives, and the interest on combined principals of ¥5,500,000 or less would be nontaxable. However, the workers' property accumulation savings plan investing in life insurance and property insurance, etc., have a nontaxable upper limit of ¥3,850,000.

4. Taxation of Dividends

In principle, not taking into consideration the special income tax for reconstruction, the balance of dividends, distributions of gains from publicly offered stock investment trusts, and other applicable income earned by stockholders or investors after the payment of a 20% withholding tax (15% in

Table XIV-5. An Outline of Dividend Income Taxation

Classification		Outline
Distributions from publicly offered stock investment trusts, etc.		<ul style="list-style-type: none"> Comprehensive taxation (may apply tax credits for dividends) (5% to 45% income tax; 10% inhabitant tax) (20% withholding (15% income tax; 5% inhabitant tax)) Select either separate taxation on the basis of self-assessment (20% (15% income tax; 5% inhabitant tax)) or withholding tax (20% (15% income tax; 5% inhabitant tax)) (non-declaration is also possible)
Dividend of surplus, dividend of profits, distribution of surplus, etc.	Dividend on listed stocks, etc. (excluding large shareholdings) (Note 1)	
	Other than above	Comprehensive taxation (tax credits for dividends) (5% to 45% income tax, 10% inhabitant tax) (20% (20% income tax) withholding)
	Dividend paid at one time is no more than: $¥100,000 \times \frac{\text{Dividend computational period}}{12}$ Items below	
		No declaration necessary (20% (20% income tax) withholding)

Notes: 1. “Dividends on listed stocks, etc. (other than those paid to large shareholders)” means those paid to shareholders holding less than 3% of the outstanding shares of the listed company.

2. In addition, from January 2013 to December 2037, a 2.1% special income tax for reconstruction is levied against the amount of income tax as a time-limited measure.

Source: Based on the web site of the Ministry of Finance.

income tax and 5% in local inhabitant tax) is subject to comprehensive taxation. When comprehensive taxation is levied on dividend income, the Income Tax Act allows the deduction of a certain percentage of dividend income (tax credits for dividends) to avoid double taxation.

For distributions, etc., of gains on publicly offered stock investment trusts and for dividends paid on listed stocks other than those paid on large shareholdings (those paid to a shareholder who holds 3% or more of the outstanding shares of a corporation), the payee of dividends has the option of adopting comprehensive taxation, separate taxation on the basis of self-assessment, or non-declaration of dividend income (withholding tax only on their dividend income). For a limited period, stockholders and investors have enjoyed a preferential tax rate of 10% (10.147% in 2013) on this income. However, from 2014 to 2037, the rate will be 20.315%, after which a tax rate of 20% will be applied. For a limited period, stockholders and investors have enjoyed a preferential tax rate of 10% (10.147% in 2013) even for separate taxation on the basis of self-assessment. However, from 2014 to 2037, the rate will be 20.315%, after which a tax rate of 20% will be applied. It was from 2009 that choosing the separate taxation on the basis of self-assessment became an op-

Table XIV-6. Taxation of Dividend Income (withheld at source) (2015)

(millions of yen)

Classification	Amount paid			Withholding tax amount
		Taxable amount	Tax-exempt amount	
Dividends on profit or interest income, distribution of retained earnings, and dividends, etc., / on interest on fund corporations	27,982,277	20,787,341	7,194,937	3,830,091
Distributions of profits of investment trusts and investment trusts with specific investment purposes	3,402,506	2,604,133	798,373	398,830
Remittance to optional withholding tax account	2,372,740	2,372,740	—	362,772
Total	33,757,523	25,764,214	7,993,309	4,591,692

Notes: 1. Bond investment trusts and investment trusts managing publicly offered bonds, etc., are not included in “investment trusts.”
 2. “Taxable amount” includes not only that paid to individuals but also that to corporations.
 3. As fractions were rounded to the nearest whole number, the figures may not add up to the actual total amounts.

Source: Compiled based on the data available on the website of the National Tax Agency of Japan.

tion. Moreover, from 2010, investors have been able to combine dividends, etc., from listed stock, etc., in their withholding tax accounts. The term “listed stock, etc.,” refers to shares that are listed on domestic and foreign stock exchanges and includes such shares as ETFs (exchange traded funds).

Meanwhile, dividends on stocks other than listed stocks (unlisted stocks) and those received by large individual shareholders are subject to comprehensive taxation after paying a 20% withholding tax (20.42% from 2013 to 2037). In this case, shareholders have the right to select the non-declaration of dividends paid at one time of no more than the amount derived by proportionally dividing ¥100,000 over the dividend-computation period. However, local inhabitant tax is subject to comprehensive taxation.

Distributions of profit from publicly offered stock investment trusts are treated as dividend income when investors opt for the comprehensive taxation method, entitling the investors to tax credits. However, the rate of deduction varies depending on the ratio of foreign currency denominated assets and non-stock assets of the stock investment trust concerned. If the percentage of either foreign currency denominated assets or non-stock assets is over 75%, the deduction of dividends is not allowed. For profits distributed by privately placed stock investment trusts of the contractual type (see section 10 below), such dividends less withholding tax are subject to comprehensive taxation (dividends are deductible).

For the purpose of computing the amount of dividend income, interest paid on a debt incurred to acquire stocks, etc., may be deducted from the taxable income. However, this is recognized only when the investor files a tax return.

5. Adjustment of Double Taxation Relating to Dividends

Profits generated by a business corporation through its business activities should, basically, be returned to the owner of that corporation. However, corporate income is usually taxed twice: corporate income tax and individual income tax (dividend tax and capital gains tax). Considering that, ultimately, it is the individuals who have the duty of paying taxes, some adjustments have to be made to avoid double taxation. This is the question of consolidating corporate tax and an individual's income tax. Ideally, all forms of double taxation of corporate income—be it retained earnings or dividends—should be rectified. However, adjustments are chiefly made to the dividend portion.

The method employed to adjust for double taxation related to dividends varies according to whether the recipients are individuals or corporations. In the case of individual shareholders, a dividend tax credit system is applied that makes 10% of their dividend income (and 2.8% for inhabitant tax) deductible from their tax liability. However, in the case of those whose taxable income exceeds ¥10 million, 5% of such part of their dividend income that pushes their taxable income over and above ¥10 million (and 1.4% for inhabitant tax) is deductible. For instance, when individual shareholders have a total taxable income of ¥13 million (¥9 million in general income and ¥4 million in dividend income), they are entitled to a tax deduction of 5% of such part of their dividend income that pushes their taxable income over and above ¥10 million, which is ¥3 million ($=¥13 \text{ million} - ¥10 \text{ million}$), and 10% of other part of their income, which is ¥1 million. Therefore, they are entitled to a tax deduction of ¥250,000 ($¥150,000 (=¥13 \text{ million} - ¥10 \text{ million}) \times 0.05 + ¥100,000 (=¥10 \text{ million} - ¥9 \text{ million}) \times 0.1$). Also, in regard to dividends received by corporate shareholders, the scope of taxable income was revised in the fiscal 2015 tax reform. As for investments in stocks with a high shareholding ratio, revisions were made to the criteria on shareholding ratio, while the entire amount of dividends received on such shares were not to be counted as taxable income. On the other hand, in regard to investments in stocks, etc. with a low shareholding ratio, a new category was established and the ratio for not counting as taxable income was partially lowered.

In foreign countries, the imputation method has broadly been adopted as a method to adjust for double taxation. The method of dividend-received deductions employed in Japan and the partial imputation method employed in the United Kingdom are both types of imputation methods. Other methods

Table XIV-7. Adjustment of Double Taxation in Major Countries (individual stage)

(As of January 2017)

Countries	Adjustment method	Remarks
Japan	[When selecting no declaration necessary or separate taxation on the basis of self-assessment] No adjustment treatment [When selecting comprehensive taxation] Dividend credit (dividend-received deduction method)	For dividends on listed stocks, etc., withholding at source is applied, allowing an option of selecting no declaration necessary and comprehensive taxation. In addition, since capital losses on stocks can be offset against gains, separate taxation on the basis of self-assessment may also be chosen.
United States	No adjustment treatment	A preferential tax rate similar to the capital gains tax is applied to a certain level of dividend income at the individual shareholder level. The U.S. abolished the adjustment treatment for corporation tax and income tax at the individual shareholder level in 1936.
U.K.	Dividend-received partial deduction method (£5,000 deducted from dividend income of individuals)	Although partial adjustment had been made based on the partial imputation method, the treatment was abolished when the £5,000 deduction from income was introduced in April 2016.
Germany	No adjustment treatment	Under the comprehensive taxation system, the dividend-received partial deduction method (50% of dividends received are included in shareholder's taxable income) was employed until 2008. However, non-declaration (separate taxation) treatment for a uniform 25% rate on interest, dividends and capital gains was introduced in 2009 as a result of which adjustment between corporate tax and income tax at the individual shareholder level was abolished.
France	Dividend-received partial deduction method (60% of dividends received are included in shareholder's taxable income)	Under the comprehensive taxation system, the dividend-received partial deduction method (60% of dividends received are included in shareholder's taxable income) was employed until 2007. However, with the introduction of a method to allow selecting of comprehensive taxation or separate taxation in 2008, no adjustment between corporate tax and income tax at the individual shareholder level was made when the separate taxation method was selected. Based on the 2013 budget law, the system of selecting separate taxation for interest, dividends and capital gains was terminated. As a result, a progressive tax rate has been applied uniformly starting with the 2013 income.

Source: Compiled based on the data in Illustrated Taxation System of Japan, FY2017 edition, page 303, Ichiro Yoshino.

used to adjust for double taxation include the dividend paid deduction method (which authorizes deduction of dividends paid on the corporate level from corporate taxable income) and the comprehensive business income tax method (CBIT). Interest and dividends are not deductible from taxable income on the corporate level, and such interest and dividends received by individuals are not subject to income tax.

6. Capital Gains Taxation (1)

In 2003, the system of opting for a separate withholding tax or for separate taxation on the basis of self-assessment for gains on the sale of stocks, etc., was abolished, and these taxes were unified into the latter system of separately filing an income tax return. In other words, not taking into account the special income tax for reconstruction, a 20% tax rate (a 15% income tax and a 5% inhabitant tax) is applied to an amount of income arrived at by deducting the cost of acquiring or selling the security and interest paid on the fund used for the purchase of such security from the proceeds of such security. The capital gains from the sale of listed stocks, etc. may be treated so as to deal with issues related to taxable income based on withholding tax only using a specified account which will be discussed later. Previous to 2003, capital losses from the sale of stocks, etc., were deductible only from capital gains from the sale of other stocks, etc., if any, made during the same year, and it was not permissible to carry forward any unused losses. However, since 2003, investors have been able to carry forward capital losses from the sales of listed stocks, etc., for three years starting with the year following their occurrence. Also, since 2009, investors have been able to deduct capital losses on listed stocks, etc., from dividends, etc., received from listed stocks, etc. Furthermore, starting in 2016, based on the change in the taxation method for bonds, etc., it became possible to offset income against losses for interest and capital gains from specified bonds, etc., and income from listed stocks, etc.

Along with the abolition of the separate withholding tax system, the authorities sought to lessen the reporting burden on investors by establishing a special account system. Under this type of account, a securities company computes capital gains or losses, as the case may be, for its customer from the sale of shares of a listed stock, etc., made through a special brokerage account. The account is divided into two categories: the income tax withholding account and the simplified income tax return account (no tax is withheld). When an investor sells his shareholdings through the income tax withholding account, his securities company withholds the income tax, obviating the need for the investor to file an income tax return. Furthermore, from 2010, it be-

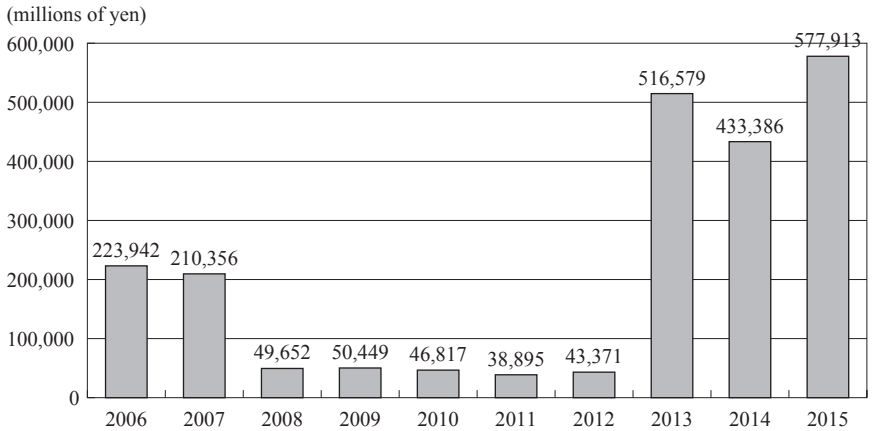
Table XIV-8. Outline of the Capital Gains Taxation System for Stocks, Etc. (from 2016)

	Outline
<div>Listed stocks, etc.<div><div>· Listed stocks</div><div>· ETF</div><div>· Publicly offered investment trusts</div><div>· Specified bonds, etc.</div></div></div>	<div>Separate taxation on the basis of self-assessment</div> <div>Capital gains on listed stocks, etc. × 20% (15% income tax: 5% inhabitant tax)</div> <div>*Special exception on no declaration necessary for withholding tax account</div> <div>For income maintained in a withholding account (specified account selected for tax withholding purpose) from the sale of listed stocks, etc. taxable-income-related issues may be completed based on withholding tax (20%: income tax 15%: inhabitant tax 5%) only.</div> <div>*Gain/loss offset and carrying-forward of unused deductible losses relating to listed stocks, etc.</div> <div>Losses from the sale of listed stocks, etc. may be deducted from the amount of dividend income, etc. on listed stocks, etc. for the same year. For unused deductible losses relating to unlisted stocks, etc., the investor may carry it forward for a three-year period starting from the following year as deduction from the amount of capital gains from listed stocks, etc. (Note 3) and the amount of dividend income, etc. from listed stocks, etc.</div>
<div>General stocks, etc. (Stocks, etc. other than listed stocks)</div>	<div>Separate taxation on the basis of self-assessment</div> <div>Capital gains on general stocks × 20% (15% income tax, 5% inhabitant tax)</div>

Notes: From January 2013 to December 2037, a 2.1% special income tax for reconstruction is separately levied against the amount of base income tax as a time-limited measure.
Source: Compiled based on information available on the website of the Ministry of Finance.

came possible for the securities company to deposit dividends from listed stocks, etc. of customers that are subject to withholding tax in the income tax withholding account set up for the customers. However, if an investor using such an account also files a final return, the investor is also allowed to include capital gains or to offset capital losses from the sale of such shares through another account. Further, in conjunction with the change in the taxation method for bonds, etc. effective 2016, the scope of application of the special account has also been widened. When an investor opts for the income tax withholding account and does not file a final return, the capital gains are not included in the total amount of his income for the purpose of income tax and local inhabitant tax, and the spousal deduction is not affected. By contrast, if an investor opts for the simplified income tax return account, such an investor may file a simplified version of the income tax return by attaching to it an annual statement of stock trading made under a special brokerage ac-

Chart XIV-2. Withholding Taxes on Capital Gains on the Sale of Listed Stock, Etc., Managed in Special Brokerage Accounts



Source: Based on the website of the National Tax Agency of Japan.

count received from his securities company. Currently, securities companies must send an annual statement of stock trading to the customer and the tax office no matter what type of special brokerage account is selected by the customer.

7. Capital Gains Taxation (2)

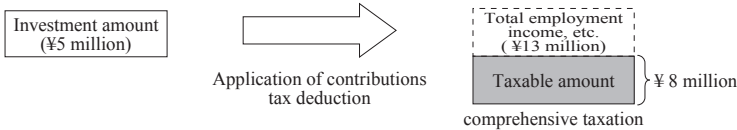
While, in principle, separate taxation on the basis of self-assessment is applied on capital gains on stocks, etc., capital gains on the sale of zero-coupon bonds, interest-bearing bonds that fall under bonds depending on the method of discount, discount bonds issued in Japan by the Japan Housing Finance Agency, the former Housing Loan Corporation, Okinawa Development Finance Corporation, Urban Renaissance Agency, foreign governments, foreign local government bodies, international organizations and such like, certain short-term discount bonds issued in Japan, and bonds (excluding discount bonds) for which no interest is paid by December 31, 2015 are subject to comprehensive taxation. In addition, capital gains on golf club membership in the form of stocks are subject to comprehensive taxation.

The Angels Taxation System was created under the fiscal 1997 amendment to the taxation system. It is a special measure designed to encourage individual investors (angels) to invest in venture-stage firms or start-ups and applies to shares (specified shares) of venture-stage firms or startups (specified

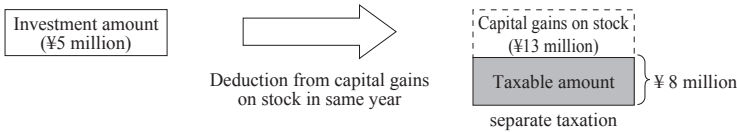
Chart XIV-3. An Outline of the Angels Taxation System

Preferential tax measures for start-up investment (selective application of methods 1 and 2)

1. When an investment is made in any venture-stage firm (specified small-to-midsize firm), the investor may apply the contributions tax deduction for up to ¥10 million.



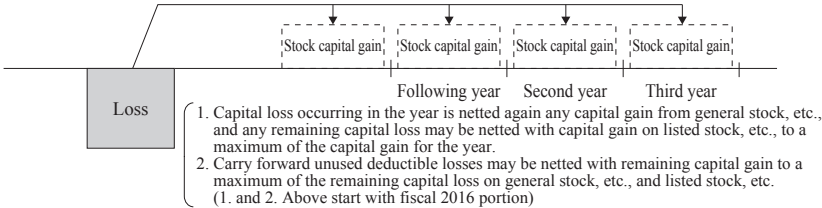
2. There is a reduction in capital gains on the stock when an investment is made in a start-up firm (specified small-to-midsize firm).



- Note: 1. When preferential tax measures 1 or 2 are applied, the acquisition costs of the stock of the start-up firm is the amount less the tax deduction stated above.
2. Tax exemption on capital gains on general stock, etc., or on listed stocks, etc. (starting with fiscal 2016 income).

Preferential tax measures following investment

3. Should the business of the start-up firm (specified small-to-midsize firm) fail, and a loss to be suffered from the sale, etc., of stock prior to listing, etc., the investor may carry forward unused deductible losses for a three-year period.



- Note: When an investor sells specified shares acquired before April 30, 2008, and held for more than three years within three years of listing or before listing by reason of a merger, the resulting capital gains are reduced by half.

Source: *Illustrated Taxation System of Japan*, 2016 edition [Zaikaishouhousha], page 113, compiled by Yoshiyuki Tahara.

small-to-midsize firms) that meet certain requirements. This taxation system has been revised several times since the establishment of this plan. Most recently, the special tax treatment reducing the rate on capital gains for specified small-to-midsize firms to 50% was extended for two years in the fiscal 2005 tax revisions. The fiscal 2007 tax reform added another two years and liberalized the eligibility requirements for the special tax treatment and rationalized the approval process. This special tax treatment was abolished under

the fiscal 2008 tax reform. However, at the same time, the government set up a contributions tax deduction system for investors that invest in these types of venture companies (specified start-up small-to-midsize firms) during their start-up period. Furthermore, under the fiscal 2016 amendment to the taxation system, the scope of stocks eligible for the Angels Taxation System was changed assuming that the Enforcement Regulations for the Local Revitalization Act be amended.

The outline of the current Angels Taxation System is as follows. (1) since April 1, 2008, investors that have acquired stock in a specified small-to-midsize firm through direct investment may apply the contribution deduction for up to ¥10 million of the amount invested in the said company (investors may choose to apply either (1) or (2) per stock issue); (2) investors may deduct the acquisition costs of shares of a specified small-to-midsize firm from their capital gains in the same year; and (3) when investors suffer losses from the sale of the specified stocks up to a day before the listing date, or when they suffer losses from the dissolution and liquidation of issuers, these losses are deductible from gains on the sale of stocks in the same year. Unused deductible losses may be carried forward for three years starting with the following year.

8. NISA

Based on the fiscal 2013 tax reform, NISA was introduced in Japan in 2014. NISA is another word for a small amount investment tax-exemption scheme, the tax exemption measure on dividends and capital gains on small investments in listed stocks, etc., in tax-free accounts. NISA is modeled on the Individual Savings Account (ISA)—a preferential tax system for investments and savings introduced in the U.K. in 1999—and it was initially referred to as the Japanese-version ISA. The “N” in NISA stands for NIPPON (Japan). This system may also be referred to as the General NISA.

An outline of NISA is provided below. Dividends, coupons, and capital gains from listed stocks, etc. in the NISA account are tax-exempt. A NISA account may be opened by residents of Japan aged 20 years or older on January 1 of the year of the account opening. The amount of annual investment was initially set at a maximum of ¥1 million making the total tax-exemption investment amount ¥5 million (¥1 million \times 5 years). However, starting in 2016, the annual investment amount was increased to a maximum of ¥1.2 million with the total tax-exemption investment amount coming in at ¥6 million (¥1.2 million \times 5 years). The NISA account may be maintained for 10 years from 2014 to 2023, with a maximum tax-exempt period of five years. Stocks, etc. may be freely sold during the period but the tax-exempt coverage

Table XIV-9. Comparison of General NISA and Installment-type NISA

	General NISA	Dollar-Cost Averaging NISA
Persons eligible to apply	Persons aged 20 or above living in Japan	
Account opening	One account per person; select either General NISA or Dollar-Cost Averaging NISA	
Account switch	Switching the General NISA account↔Dollar-Cost Averaging NISA account By applying for the account switch procedure, the other product can be used. (Note) If a user applies for a loan under the General NISA account, no switching to the Dollar-Cost Averaging NISA is allowed during the year.	
Tax-exempt period	Up to 5 years from the initial year of investment	Up to 20 years from the initial year of investment
Tax-exempt product	Listed stocks, stock investment trusts, etc.	Investment trusts that satisfy certain requirements as appropriate means of long-term, installment and diversified investment
Limit of usage (Tax-exempt line)	Up to ¥1.2 million a year	Up to ¥0.4 million a year
Investment period	Until December 31, 2023	Until December 31, 2037
Netting of profit and loss	No netting of profit and loss with a specified account and general account	
Early sale	Yes (no reuse of the sold portion)	
Change of financial institution	Possible to change by year	
Others	Must provide My Number at the time of account opening	
		Method of purchase is limited to periodical purchase (e.g. once a month) of a certain amount (installment investment)

Source: Compiled based on the data available on the website of the Japan Securities Dealers Association (JSDA).

of the sold portion cannot be reused. Although initially account-holders were not permitted to switch the financial institution at which the NISA account is opened for a maximum of four years, effective January 1, 2015, the rule was changed to allow switching of the financial institution on a yearly basis.

Furthermore, based on the fiscal 2015 tax reform, Junior NISA (a small amount investment tax-exemption scheme on dividends and capital gains on small investments in listed stocks, etc., in tax-free accounts of underaged persons) was introduced from 2016. Under the Junior NISA scheme, the tax exemption treatment applies on dividends and capital gains on small investments in listed stocks, etc., in tax-free accounts opened by persons under the age of 20. The maximum annual investment amount is ¥800,000, making the maximum tax-exempt investment amount ¥4 million (¥800,000 × 5 years). The account may be opened for eight years from 2016 to 2023 and the maximum tax-exempt period is set at five years. In principle, no withdrawal can

Table XIV-10. Outline of Junior NISA

Tax-Exempt	Small amounts of dividends and capital gains on listed stocks in tax-free Junior NISA account
Eligible account openers (investors)	Residents under the age of 20 on January 1 of the year of account opening or born in the year
Maximum annual investment	¥800,000
Tax-exempt investment amounts	Maximum of ¥4 million
Account opening period	8 years from 2016 to 2023
Tax-exempt period	Maximum of 5 years
Investment management	Investments are made by agency or upon concurrence of a person with parental authority and, in principle, no withdrawal can be made until the account holder reaches the age of 18.

Source: Compiled based on various data issued by the National Tax Agency and the Ministry of Finance

be made until the account holder reaches the age of 18.

Furthermore, based on the fiscal 2017 tax reform, the Dollar-Cost Averaging NISA will be launched from 2018. The primary characteristics of the product are: (1) investors can start by making contributions in small amounts to tax-exempt investment trusts; (2) investors can contribute up to ¥400,000 a year, with capital gains tax exempt for up to 20 years; (3) investors hold only one NISA account, either the general NISA or the Dollar-Cost Averaging NISA; and (4) the applicable investment trusts are expected to be appropriate for long-term installment and diversified investment aimed at stable asset formation as provided for under relevant laws and regulations.

9. Taxation of Nonresidents

The Income Tax Act of Japan divides individuals into residents and nonresidents. Residents are individuals who have a domicile in Japan or a temporary residence at which they have been living for one year or more. All individuals other than residents are deemed nonresidents. Of the residents, individuals who do not have Japanese citizenship and who have or have had a domicile in Japan or a temporary residence at which they lived for a total of no more than five years in the past 10 years are referred to as non-permanent residents. The entire income (worldwide income) of residents other than non-permanent residents is subject to income tax. For non-permanent residents, income generated in Japan (domestic source income) and other income

Table XIV-11. Outline of Matters Related to Taxation of Nonresidents, Etc.

Nonresident category Type of income	Nonresidents with a permanent establishment in Japan		Nonresidents without a permanent establishment in Japan	Withholding tax
	Income attributable to permanent establishment	Other income sourced in Japan		
(Business income)	[Comprehensive taxation]	[Tax-Exempt Income]		None
(1) Income arising from investment/holding of assets *Excluding those corresponding to (7) through (15) below		[Comprehensive taxation (partial)]		None
(2) Income arising from transfer of assets				None
(3) Distribution of business profit of partnership	[Separate withholding tax followed by comprehensive taxation]	[Tax-Exempt Income]		20.42%
(4) Proceeds from sales of land, etc.		[Separate withholding tax followed by comprehensive taxation]		10.21%
(5) Compensation for personal services				20.42%
(6) Rental income, etc., from real estate				20.42%
(7) Interest, etc.		[Separate withholding tax]		15.315%
(8) Dividends, etc.				20.42%
(9) Loan interest				20.42%
(10) Usage fees, etc.				20.42%
(11) Salary or other remuneration for personal services, public pension income, severance pay, etc.				20.42%
(12) Prize money from business advertising and promotion				20.42%
(13) Annuity income, etc., from life insurance contract				20.42%
(14) Interest payment from investment savings plan				15.315%
(15) Distribution of profit from anonymous partnership, etc.				20.42%
(16) Other income sourced in Japan	[Comprehensive taxation]	[Comprehensive taxation]		None

Notes: 1. Income attributable to permanent establishment may overlap with income sourced in Japan provided in (1) through (16) above.

2. Based on the provisions of the Act on Special Measures Concerning Taxation, certain income included in the income subject to comprehensive taxation in the above table may be applicable for separate taxation on the basis of self-assessment or separate withholding tax.

3. Based on the provisions of the Act on Special Measures Concerning Taxation, withholding tax rates relating to certain income among the withholding tax rates in the above table may be reduced or exempted in some cases.

Source: Compiled from “Withholding Tax Basics,” FY2017 edition, National Tax Agency of Japan.

earned in Japan or income remitted to Japan is taxable. And for nonresidents, tax is imposed on their domestic source income only. The method of imposition of income tax for nonresidents, i.e. whether the comprehensive taxation applies or the separate withholding tax applies, varies depending on the type of domestic source income, whether the nonresident has a permanent establishment (PE) in Japan or not, and whether the domestic source income is traced to the PE. A permanent establishment refers to (1) a branch, plant, or other fixed location for business in Japan of a nonresident, etc.; (2) a place for construction in Japan of a nonresident, etc.; or (3) a party in Japan which has the right to enter into a contract for a nonresident, etc. or any party equivalent thereof.

For example, looking at the taxation system for interest and dividends, of the domestic source income of a nonresident, etc., income attributable to a permanent establishment of the nonresident, etc. (income attributable to PE) is subject to comprehensive taxation after withholding at the source, while income other than that corresponding to income attributable to PE is subject to a separate withholding tax. The withholding tax rate is 15.315% and 20.42%, respectively. The withholding tax rates applied to nonresidents and foreign corporations are finally determined in accordance with the tax treaties Japan has signed with the countries where nonresidents, etc. receiving the payments reside.

Japanese government bonds owned by nonresidents are tax exempt. In other words, interest on government bonds held by a nonresident without a permanent establishment in Japan in an account with a specified central custody and transfer agent or a qualified foreign intermediary is exempt from income tax if it meets certain conditions. In addition, while interest on book-entry government bonds may not be tax-exempt, the withholding tax rates applied to nonresidents and foreign corporations are relaxed in accordance with the tax treaties Japan has signed with the countries where nonresidents, etc. reside.

10. Tax Treatment of New Products

(1) New types of investment trusts

Profits received from a privately placed stock investment trust of the contractual type are, in principle, subject to a withholding tax and then are taxed comprehensively together with other incomes of the recipients of such profits. The tax credit for dividends is also applied, and when the recipient meets certain requirements, he is exempted from the requirement of filing an income tax return. Capital gains from selling beneficiary certificates of such investment trusts are subject to separate taxation on the basis of self-assess-

Table XIV-12. Outline of Taxation Framework for New Investment Trusts

Classification		Profit distribution, etc.	Cancellation (redemption) gains	Capital gains
Contractual type	Privately placed stock investment trusts	Taxable as dividend income	Taxable as dividend income; separate taxation on the basis of self-assessment applies to the portion deemed capital losses	Separate taxation on the basis of self-assessment
	Investment trusts managing privately placed asset-management trust bonds, etc.	Separate withholding tax	Separate withholding tax; separate taxation on the basis of self-assessment applies to the portion deemed capital losses	Separate taxation on the basis of self-assessment
Corporation type	Publicly offered	Open-end type	Separate taxation on the basis of self-assessment, comprehensive taxation, no declaration	Separate taxation on the basis of self-assessment
		Closed-end type (Unlisted)	Taxable as dividend income	Separate taxation on the basis of self-assessment
	Privately placed		Taxable as dividend income; separate taxation on the basis of self-assessment applies to the portion deemed capital losses	Separate taxation on the basis of self-assessment

Source: Compiled based on the information available in “FY2017 Zeikin no Chishiki (knowledge on taxes)” by SMBC Nikko Securities Solution Planning Division; CHUOKEIZAI-SHA, INC.; pp124 and 130; and “FY2017 Zeikin Dokuhon (tax handbook)” by Daiwa Institute of Research Ltd., pp 186.

Table XIV-13. Taxation on Stock Options

	At grant of stock options	At exercise of stock options	At the sale of stocks
Qualified stock options	—	—	Separate taxation on the basis of self-assessment on (selling price - exercise price) ^(Note)
Non-qualified stock options	—	Comprehensive taxation on (market value of stocks at exercise-exercise price)	Separate taxation on the basis of self-assessment on (selling price - market value of stocks at exercise) ^(Note)

Note: Taxed as income on the sale of stocks.

ment. Profits received from an investment trust managing privately placed bonds are subject to a separate withholding tax, and capital gains, which used to be tax-exempt, are currently subject to separate taxation on the basis of self-assessment. Tax rates related to open-ended corporation type investment trusts are the same as those applied to listed stocks. In other words, on dividends received from open-end investment trusts, a withholding tax of

20.315% is imposed before comprehensive taxation, separate taxation on the basis of self-assessment, or non-declaration. A credit for dividends is not applied when the comprehensive taxation is selected on dividends. Capital gains associated with open-ended corporation type investment trusts are subject to the separate taxation on the basis of self-assessment. On the other hand, dividends received from closed-end (unlisted) or privately placed investment trusts are subject to a withholding tax of 20.42% and then to comprehensive taxation. In general, a taxation system is selected that does not require the declaration of such income when certain requirements are satisfied. A credit for dividends is not applied when the comprehensive taxation is selected on dividends. Capital gains associated with open-ended corporation type investment trusts are subject to the separate taxation on the basis of self-assessment. For REITs (real estate investment trusts), if listed would be closed-end, but dividends and capital gains from the sale of listed REITs are subject to almost the same taxation as listed stocks. However, a credit for dividends is not applied when comprehensive taxation is selected on dividends.

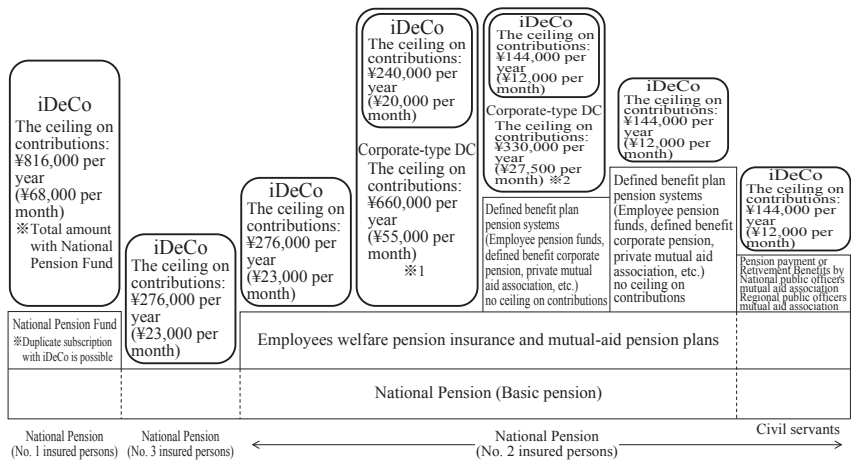
(2) Stock options

The stock option system is a system under which a company grants its officers and employees the right to purchase its stocks at a certain price (exercise price) for a certain period (exercise period). The company then pays its officers and employees remunerations linked to any increase in its stock price. Stock option is classified into a qualified stock option and a non-qualified stock option, depending on whether it satisfies the requirements stipulated in the Act on Special Measures Concerning Taxation or not. The former is tax deductible on economic benefits gained from its exercise (the difference between the market price and the exercise price). When selling stocks acquired through rights exercise, separate taxation on the basis of self-assessment is applied on the difference between the selling price and the exercise price. For the latter non-qualified stock option, comprehensive taxation is imposed on economic benefits gained from its exercise. Separate taxation on the basis of self-assessment is imposed on the selling price of stocks issued on the exercise, deducting the market price of the stocks at the time of exercise, when the stocks are sold.

11. Tax Treatment of Pension-Type Products

To cope with the economic and societal changes that have occurred over the years—a swollen unfunded corporate pension obligation, a growing shortage of public pension funds, the introduction of international accounting stan-

Chart XIV-4. Beneficiaries of Defined Contribution Pension, Ceiling on Contributions, and the Existing Pension System (2017)



Source: The web site of the Ministry of Health, Labor and Welfare (<http://www.mhlw.go.jp>).

dards, and an increasing slackness in the job market—a defined contribution pension plan (the Japanese version of the 401(k) plan) was introduced in October 2001. The defined contribution pension plan is a private pension plan whereby an employee participating in the plan gives instructions about investing his or her contributions, with the understanding that pension benefits may vary depending on the results of such investment. It is divided into the individual type (iDeCo), in which the individual himself makes contributions, and the corporate type, in which the company in principle makes contributions on behalf of its employees. In order to encourage the spread of pension products based on such a system and to enhance the efficiency of the management of such plans, it is essential to give a fixed tax incentive. And in devising such a taxation system, due care must be exercised in striking a suitable balance between the taxation system for such pension plans and that for other pension plans as well as in the transferability of pension assets when changing jobs. The government has taken the following tax measures applicable to defined contribution pension plans.

Tax measures for defined contribution plans are as follows.

(1) At the contribution stage: Premiums paid to a pension plan of the indi-

Table XIV-14. Tax Treatment of Defined Contribution Pension Plans

Division		Individual type	Corporate type
Contribution stage:			Counted as a loss of the employer and not added to the salary of the employee
	Portion borne by the employer		
	Premiums paid by employee	Premiums to small-scale company mutual aid association are deducted as a loss (Note)	
Management stage:		Special corporate income tax is applied (frozen until the end of Fiscal 2016)	
Benefits payment stage:			
Old-age benefits	Pension	Miscellaneous income (deduction for public pensions is applied)	
	Lump sum	Retirement income (deduction for retirement income is applied)	
Disability benefits	Pension	Income and inhabitants' taxes are deductible	
	Lump sum		
Lump-sum payment at the time of death		Taxed as an inheritance income	
Lump-sum payment at the time of withdrawal		Occasional income	

Note: Premium payments by employees for Corporate type of plan started in January 2012.

vidual type by a self-employed person are eligible for income deduction (deduction for small enterprise mutual relief premium). Premiums paid to corporate pension plans by a company are counted as a loss of such company and are not counted as an income of the employee for whom such premiums are paid. As of January 2012, matching contributions by employees have been approved for corporate pension plans. Therefore, the entire amount of contributions by employees is eligible for the deduction for the small enterprise mutual relief premium.

(2) At the management stage: The balance of reserves for a pension plan of the individual type and that of the corporate type are subject to a special corporate tax of 1.173% (1% in national tax and 0.173% in local tax). However, this provision has been frozen until March 31, 2020.

(3) At the stage of benefit payment: (i) Old-age pension benefits: The beneficiary can receive pension benefits from the reserve in five or more annual installments or in a lump sum. When the beneficiary opts for benefits in installments, such benefits are deductible from taxable income. The amount deductible varies according to the age of the beneficiary and the amount of income the beneficiary receives from publicly managed pension plans. However, a minimum benefit of ¥1.2 million is recognized for those who are 65 years of age or older or ¥700,000 for those who are less than 65 years of age.

Benefits paid in a lump sum are eligible for retirement income deductions.

(ii) Benefits for persons with disabilities: When a beneficiary has disabilities of a certain level, the beneficiary can receive the payment of benefits from the month in which he or she is disabled, and the benefits are exempted from income tax and inhabitant tax. (iii) Death benefits: Death benefits paid in a lump sum to the survivors when the subscriber died are deemed as inherited property, and up to ¥5 million for each legal heir is exempted from inheritance tax. (iv) Withdrawal benefits: Benefits paid in a lump sum upon withdrawal from a pension plan are subject to income tax and inhabitant tax provided that certain criteria are fulfilled.

CHAPTER XV

Prohibited and Regulated Acts of Securities Trading

1. Outline

With a view to establishing a fair securities market and enhancing its credibility, the Financial Instruments and Exchange Act (FIEA) provides for various prohibited and regulated acts. They include a ban on market manipulation (see section 2); insider trading by persons associated with the companies concerned (see section 3); and discretionary-account trading and massive promotional campaigns on particular securities by securities companies (see section 4). In addition, the Financial Instruments and Exchange Act requires trade participants to disclose certain transaction-related information, such as the submission of reports of possession of large volume, to ensure the fairness of securities transactions (see section 5).

However, it is practically impossible to list in the Financial Instruments and Exchange Act all unfair trading in connection with securities transactions. In addition, as those securities transactions are complex and their structure changes rapidly, new methods that were unforeseeable at the time of legislation could emerge later. Faced with such issues, Article 157 of the Financial Instruments and Exchange Act bans unfair transactions in broad terms. More specifically, it prohibits the use of wrongful means, schemes, or techniques with regard to the sale, purchase, or other transaction of securities, etc. (Item (i) of the article); the acquisition of money or other property using a document or other indication which contains false indication on important matters or lacks indication about important matters necessary for avoiding misunderstanding with regard to the sale, purchase, or other transaction of securities, etc. (Item (ii)); and the use of false quotations in order to induce the sale, purchase, or other transaction of securities, etc. (Item (iii)). This article is considered to be a general provision that comprehensively prohibits wrongful acts, including new types of unfair trading yet to emerge.

In addition to the above, Article 158 of the FIEA prohibits the spreading of rumor, use of fraudulent means, assault, or intimidation for the purpose of carrying out the sale, purchase, or other transaction of securities, etc., or causing a fluctuation of quotations on securities, etc. Article 168 prohibits the

Table XV-1. Main Provisions Relating to the Ban on Unfair Trading

	Contents	Article of the Financial Instruments and Exchange Act (FIEA)
General provisions	<ul style="list-style-type: none"> • Prohibition of wrongful acts 	Art. 157
Market manipulation	<ul style="list-style-type: none"> • Prohibition of fake transactions or prearranged transactions • Prohibition of transactions aimed at manipulating securities prices • Prohibition of making an indication with the aim of manipulating securities prices • Prohibition, in principle, of stabilization transactions • Prohibition of purchase for own account during the stabilization period • Prohibition of spreading of rumors or use of fraudulent means, assault, or intimidation • Prohibition of securities companies from getting involved in an artificial formation of stock prices • Prevention of use of corporate share repurchase for manipulating stock prices 	<p>Art. 159, Para. 1</p> <p>Art. 159, Para. 2, Item (i)</p> <p>Art. 159, Para. 2, Items (ii) and (iii)</p> <p>Art. 159, Para. 3, and Arts. 20-26 of the Order for Enforcement of the Act</p> <p>Art. 117, Para. 1, Item (xxii) of the Cabinet Office Order on Financial Instruments Business, etc.</p> <p>Art. 158</p> <p>Art. 117, Para. 1, Item (xx) of the Cabinet Office Order on Financial Instruments Business, etc.</p> <p>Art. 162, Para. 2</p>
Insider trading	<ul style="list-style-type: none"> • Prohibition of insider trading • Duty of officers to report securities transactions and the duty to retribute profits made in short-term trading • Prohibition of short selling by officers • Prohibition of disclosure of information and inducement of insider trading • Prohibition of accepting orders that are suspected to be in violation of insider trading regulations 	<p>Arts. 166 and 167</p> <p>Arts. 163 and 164</p> <p>Art. 165</p> <p>Art. 167-2</p> <p>Art. 117, Para. 1, Item (xiii) of the Cabinet Office Order on Financial Instruments Business, etc.</p>
False indication	<ul style="list-style-type: none"> • Prohibition of public notice, etc., of false quotations • Restriction on the expression of opinion in newspapers, etc., for consideration • Prohibition of indication of advantageous purchase, etc. • Prohibition of indication of a fixed amount of dividends, etc. 	<p>Art. 168</p> <p>Art. 169</p> <p>Art. 170</p> <p>Art. 171</p>
Tender offers	<ul style="list-style-type: none"> • Regulations on tender offers • Filing of Report of Possession of Large Volume 	<p>Art. 27-2 through 27-22-4</p> <p>Art. 27-23 through 27-30</p>
Others	<ul style="list-style-type: none"> • Prohibition of compensation of loss • Restriction on Transactions conducted for their own account and excessive transactions • Regulations on short selling • Prohibition of massive promotional campaign of particular securities • Restriction on front-running • Ban on deliberate market manipulation by means of trading securities for own account 	<p>Art. 39</p> <p>Art. 161</p> <p>Art. 162</p> <p>Art. 117, Para. 1, Item (xvii) of the Cabinet Office Order on Financial Instruments Business, etc.</p> <p>Art. 117, Para. 1, Item (x) of the Cabinet Office Order on Financial Instruments Business, etc.</p> <p>Art. 117, Para. 1, Item (xix) of the Cabinet Office Order on Financial Instruments Business, etc.</p>

publishing of false quotations on market prices of securities, etc. Restrictions on expression of opinions in newspapers, etc., in exchange for consideration are stipulated in Article 169, while Articles 170 and 171 prohibit indication of advantageous purchase, etc., and that of a fixed amount of dividends, etc., respectively.

Although OTC-handled securities (green sheet issues) also became subject to unfair trading regulations based on the amendment enforced in 2004, given the scheduled termination of the green sheet system on March 31, 2018, new designation has been terminated.

2. Regulation of Market Manipulation

Market manipulation is an act of artificially influencing securities prices that would otherwise be determined by the securities market through natural supply and demand. With a view, therefore, to ensuring fair price formation in securities markets and protection of investors, the Financial Instruments and Exchange Act prohibits market manipulation and imposes heavy penalties for the violation thereof.

Acts of market manipulation are largely divided into the following five types: (1) fake transactions, (2) prearranged transactions, (3) price manipulation, (4) indication made for the purpose of market manipulation, and (5) stabilization transactions (Article 159).

A fake transaction is a securities transaction in which the same person places purchase and sale orders during the same time frame with no actual change in ownership occurring. With prearranged trades, similar transactions are carried out in collusion with different persons. In both cases, the intention is to mislead other investors into thinking trading in the security is very active; the requisite for being deemed a wash transaction is the existence of someone whose purpose is to mislead other investors regarding trading status. Price manipulation refers to an act of engaging in transactions that could possibly cause a fluctuation in securities prices for the purpose of misleading (inducing) other persons into believing that, despite intentional price manipulation, the prices are determined by natural supply and demand, and thus inducing them to purchase or sell the securities. (Supreme Court ruling on the *Kyodo Shiryō* case, July 20, 1994)

Stabilization transactions are transactions done for the purpose of pegging, fixing, or stabilizing the prices of specific securities. However, when primary offerings and secondary distributions are made, there is the concern that flooding the market with the securities could result in a large decline in the security price, making it difficult to float the issue. For that reason, stabilization transactions are only permitted with a primary offering or secondary dis-

Table XV-2. Provisions of the Financial Instruments and Exchange Act Relating to Market Manipulation

Fake transactions	No person shall, for the purpose of misleading other persons about the state of securities transactions, conduct fake sale and purchase of securities without the purpose of transferring a right (Art. 159, Para. 1, Items (i) through (iii)).
Prearranged transactions	No person shall, for the purpose of misleading other persons about the state of securities transactions, conduct sale and purchase of securities at the same time and price, etc., based on collusion with another party (Art. 159, Para. 1, Items (iv) through (viii)).
Price manipulation	No person shall, for the purpose of inducing the sale and purchase of securities in securities markets, conduct sales and purchases of securities that would cause fluctuations in the prices of the securities (Art. 159, Para. 2, latter part of Item (i)).
Market manipulation by indication	No person shall, for the purpose of inducing the sale and purchase of securities in securities markets (1) spread a rumor to the effect that the prices of the securities would fluctuate by his/her own or other party's market manipulation (Art. 159, Para. 2, Item (ii)) or (2) intentionally make a false indication or an indication that would mislead other parties with regard to important matters when making a sale and purchase of securities (Art. 159, Para. 2, Item (iii)).
Stabilization transactions	No person shall conduct sales and purchases of securities in violation of a cabinet order for the purpose of pegging, fixing, or stabilizing the prices of the securities (Art. 159, Para. 3).

tribution of securities pursuant to the provisions of a cabinet order.

The offense of market manipulation carries a punishment of imprisonment with work for not more than 10 years or a fine of not more than ¥10 million. In some cases, both penalties can be inflicted and the property gained through market manipulation confiscated and, if it cannot be confiscated, the value thereof shall be collected from the offender. If market manipulation is conducted by trading securities for the purpose of gaining property benefits (indirect financial benefits), the offense is subject to a punishment of imprisonment with work for not more than 10 years or a fine of not more than ¥30 million. The offense is also subject to an Administrative Surcharge Payment Order. Moreover, there are provisions on liability for compensation for damages claims for investors in violation of market manipulation regulations (Article 160 of the FIEA).

In the Cabinet Office Order on Financial Instruments Business, etc., securities companies are prohibited from accepting the entrustment of orders from customers with the knowledge or expectation that acceptance of the entrustment may lead to artificial market manipulation and are required to have in place trading surveillance systems for the prevention of such violations.

3. Prohibited and Regulated Acts of Corporate Insiders

Regulations concerning the acts of corporate insiders are largely classified into two categories: those prohibiting insider trading per se and those designed for its prevention.

Prohibition of Insider Trading

“Insider trading” refers to acts of effecting the sale, purchase, or other type of transaction of securities pertaining to any unpublished corporate information that may significantly influence the decision-making of investors before such information is publicized by an insider of a listed company who has come to know the information through the performance of his/her duties or due to his/her position (Article 166). If such transactions were to take place, the investing public would be put at a significant disadvantage and the credibility of the securities markets would be seriously undermined.

With a view to effectively checking insider trading and in keeping with the modernization of the securities market, Japan’s insider trading regulations were introduced in an amendment to the Securities and Exchange Law in April 1989. The regulation framework has since been extended to include company splits, corporate share repurchases and other activities, with the relevant legislative changes effected thereafter. In 2013, further amendments (1) expanded the scope of criminal charges and Administrative Surcharge Payment Orders to include disclosure of information and inducement of insider trading by a corporate insider and (2) expanded the scope of regulation to include REIT transactions.

Since the introduction of the regulation, penalties for insider trading have been increased stepwise to punishment by imprisonment with work for not more than five years or a fine of not more than ¥5 million. In some cases, both penalties can be inflicted. For the case of a legal entity, it is subject to a fine of not more than ¥500 million. And the property gained through insider trading shall be confiscated and any deficient amount collected from the offender. In addition, when receiving an Administrative Surcharge Payment Order, the offender must pay an amount equivalent to the profit made (half the profit in the case of disclosure of information and inducement of insider trading by a corporate insider) to the government treasury.

Preventing Insider Trading

Along with the prohibition of insider trading, the officers and principal shareholders of listed companies, etc., are required to officially report any transactions in the shares of the company concerned. They are required to return to the company any short-term trading profit they have made in the shares of

Table XV-3. An Outline of the Targets of Regulations, Materials Facts, Methods of Announcement Relating to the Regulation of Insider Trading

Item	Outline
1. Targets of regulation (1) Persons associated with the company	<p>(i) Directors of the listed company (directors, officers, agents, key employees) → information not announced to the public that came to their knowledge</p> <p>(ii) Persons who have the right to inspect the books and accounting records of the company (for example, those who hold 3% or more of the outstanding shares of the company) → Information not announced to the public that came to their knowledge in the course of the exercise of the right to inspect the books and accounting records of such company</p> <p>(iii) Persons who have the power vested in them by laws and regulations to inspect the books and accounting records of listed companies (for example, officials of the regulatory agencies) → Information not announced to the public that came to their knowledge in the course of the exercise of such power</p> <p>(iv) Persons who have concluded a contract with the listed company (for example, banks, securities companies, certified public accountants, lawyers, etc.) → Information not announced to the public that came to their knowledge in the course of negotiating, signing, and performing a contract.</p> <p>(v) In case any person referred to in (ii) or (iv) above is a corporation or director, etc., of such corporation → Information not announced to the public that came to such person's knowledge in the course of performing his/her official duty</p>
(2) Recipients of information	<p>(i) Persons who have received information concerning a material fact from persons associated with the company</p> <p>(ii) Directors of a corporation to which the person who has received information concerning a material fact from a person associated with the company belongs and who have learned of information not announced to the public in the course of the performance of their duty</p>
2. Material facts	
(1) Matters decided	<p>A decision made by a decision-making body of the listed company to carry out or not to carry out the matters set forth below: The issuance of new shares, a decrease in capital, the acquisition or disposal of its own shares, a stock split, a change in the amount of dividend, a merger with another company, transfer of business, dissolution of the company, commercial production of a newly developed product or commercial application of a new technology, an assignment or acquisition of fixed assets, etc.</p>
(2) New facts	<p>When any of the facts set forth below has occurred to the listed company: A loss caused by a disaster; a change in major shareholders; a development that could cause a delisting of its shares; lawsuits relating to a claim against the property right of the company; an administrative disciplinary action ordering the suspension of business, etc.; a change in the parent company; a petition for bankruptcy of the company; a failure by the company to honor its notes or bills falling due; suspension of business with its bank; or the discovery of natural resources, etc.</p>
(3) Information on settlement of accounts	<p>When newly announced results, projected or actual, are significantly at variance with those announced earlier: Sales (10% or more up or down); current profit (30% or more up or down, and its ratio to the total net assets is 5% or more up or down); net profit (30% or more up or down, and its ratio to the total net assets is 2.5% or more up or down)</p>
(4) Others	Material facts, other than those listed in (1)–(3) above, relating to the management, business, or property of a listed company that have a profound influence on the investment decisions the investors make
(5) Material facts related to subsidiaries	(1) to (4) above apply
3. Methods of announcing information	<p>When a company notifies the stock exchange on which its stock is listed of material facts and the material facts are placed on the website of the stock exchange that received the information for public inspection. When twelve hours must elapse after the company that has issued the stock in question has disclosed its material facts to two or more news media. When a company has notified the stock exchange on which its stock is listed, and the stock exchange has placed the securities report, etc. containing the information notified on its web site for public inspection.</p>

Note: Any person who had been associated with any listed company and had learned of a material fact of such company as set forth above and who is no longer associated with such listed company is subject to these regulations for one year after that person dissolves association with the company.

the company held for a period of six months or less, and they are prohibited from selling the securities, etc., of the company in excess of the share certificates, etc., of the company that they hold.

Checks by securities companies on orders they receive and internal frameworks of listed companies (to manage and control corporate information and regulate employee trading of company shares) and posting information on J-IRISS play a critical role in preventing insider trading. J-IRISS stands for Japan-Insider Registration & Identification Support System, a searchable database where securities companies regularly register information on their customers and listed companies post information on their directors.

4. Prohibited and Regulated Acts for Financial Instruments Business Operators (Securities Companies) and Their Employees, Officers, and Directors

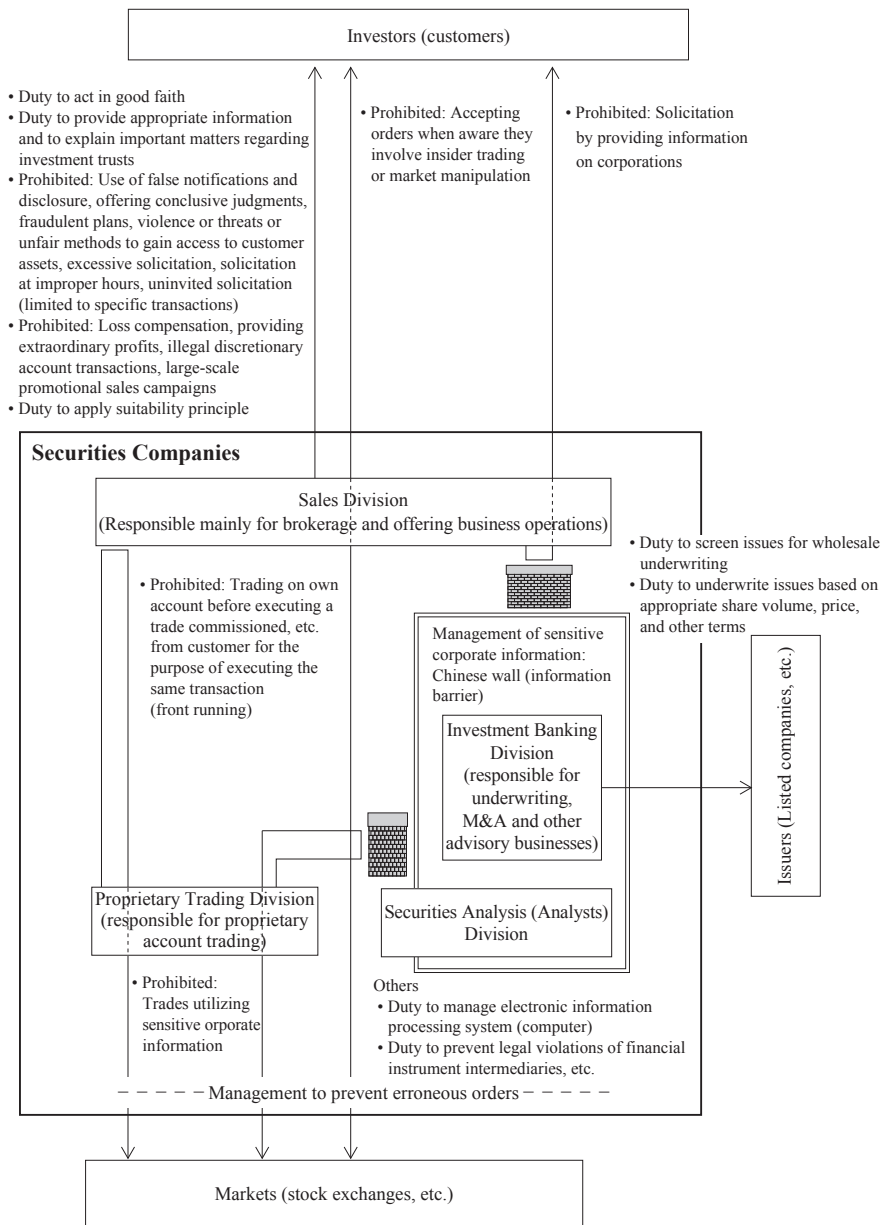
Various regulations, mainly items as follows, have been set out for securities companies and their employees, officers, and directors from the standpoint of ensuring the protection of investors, the fairness of transactions, and other aspects of trading.

Business Relationships with Customers

From the perspective of investor protection, securities companies must execute business with customers in good faith and fairly. Securities company personnel have a duty to provide customers with appropriate information and the use of false notifications or disclosure, fraudulent means, violence or threats or other unfair methods to gain access to customers' assets is banned as is the use of excessive solicitation. Meanwhile, to ensure fairness in transactions, personnel are barred from compensating customers for losses, providing them with extraordinary profits or concluding a discretionary investment contract with customers without establishing the appropriate management system—even if the customer requests such services. Securities company personnel are also prohibited from receiving consignment when being aware that a customer transaction corresponds to insider trading or market manipulation.

Securities companies must conduct their business operations in such a way as to avoid being deficient in protecting investors, such as solicitations that are recognized as inappropriate for the customer in light of his/her level of knowledge, experience, and financial resources and the purpose of concluding the financial instruments transaction contract (Suitability Rule).

Chart XV-1. Major Prohibited and Regulated Acts of Securities Companies (Duties and Prohibited Acts)



Management of Sensitive Corporate Information

Through their underwriting and M&A-related advisory and other businesses, securities companies have access to undisclosed information that could influence the stock price, etc. of issuers (sensitive corporate information). To prevent unfair trading based on such information, securities companies are required to establish appropriate systems. Specifically, securities companies can set up an information barrier (Chinese Wall) between the investment banking and similar divisions that regularly deal with sensitive corporate information and the rest of their operating divisions to enable proper management of information-sharing in-house. In addition, personnel are forbidden to use sensitive corporate information to solicit customers or to engage in trading.

Management to Prevent Erroneous Orders

Securities companies are required to establish management systems to prevent erroneous orders (name of issue, number of shares, share prices, etc.).

Management of Information Processing Systems

Securities companies are tasked with adequately managing the information processing systems (computer systems) used to conduct their businesses.

Besides the previously mentioned areas, Article 117, Paragraph 1 and Article 123, Paragraph 1 of the Cabinet Office Order on Financial Instruments Business, etc. and the self-regulation rules of the Japan Securities Dealers Association and each Financial Instruments Exchange, etc., set out various strongly advised or required management systems for securities companies.

5. Other Regulated Acts—Information Disclosure to Ensure Fairness of Transactions

A tender offer or takeover bid (TOB) is a type of corporate action in which an acquiring company publicly announces its offer to buy a certain number of share certificates, etc. of a target company at a certain price in a certain period of time in an aim primarily to gain control of the target company. Since such an offer involves purchasing share certificates, etc. from an unspecified number of investors off the exchange, the bidder is expected to disclose information by which investors can judge whether or not to sell the respective shares and deal with shareholders in a fair and rightful manner. Additionally, as it is likely that control over the target company may be transferred as a result of the takeover bid, disclosure of information on the buyer is also required. Given such factors, takeover bidders are required to: (1) publish the purpose of TOB, purchase price, number of shares to be pur-

Table XV-4. Flow of Tender Offer

- (1) Begin offer
 - Publicly announce the start of tender offer (TOB) (publish the purpose of TOB, purchase price, number of shares to be purchased, purchase period, etc. in a daily newspaper).
 - On the date of the public notification, file the Tender Offer Notification addressed to the Prime Minister and send copies thereof to the target company of TOB, stock exchanges, and parties that have submitted the Tender Offer Notification regarding the company.
- (2) Purchase period (as a general rule, a period of 20 days or more and up to 60 days)
 - Issue the Tender Offer Statement to parties intending to sell or offer stock certificates, etc.
 - Terms of TOB purchase price are consistent; decrease of purchase price and reduction of purchase period are not allowed as a general rule.
 - Withdrawal of application for purchase and cancellation of contract are not allowed as a general rule. Obligation to purchase all shares if the allotment ratio of stock certificates, etc. after the TOB exceeds two-thirds
 - The party intending to sell or offer may cancel the contract at any time
 - The target company submits its Position Statement addressed to the Prime Minister and sends copies thereof to the takeover bidder and the stock exchange.
 - The party intending to execute a TOB is prohibited, as a general rule, from purchasing the respective shares, etc. through a method other than TOB
- (3) Completion of purchase
 - Issue a public notice or disclosure regarding the number of stock certificates, etc. associated with the TOB and submit the Tender Offer Report to the Prime Minister.
 - Send the notice containing the number of stock certificates, etc. for TOB to applying shareholders.
 - Settle purchases without delay.

Table XV-5. Flow of Disclosure of Possession of Large Volume of Shares

- (1) Obligation to submit the Report of Possession of Large Volume arises
 - A shareholder or joint shareholder submits, if its holding ratio of share certificates, etc. exceeds 5% of the total number of issued shares, the Report of Possession of Large Volume (containing shareholder or joint shareholder's name and address, business description, matters concerning the holding ratio of share certificates, purpose of holding, matters concerning purchase funds, etc.) to the Prime Minister within five business days from the occurrence of the obligation, and sends copies of the Report to the stock exchange and the issuing company.
 - In the case of an institutional investor, etc., if its holding ratio of share certificates does not exceed 10% of the total number of issued shares, the Report of Possession of Large Volume may be submitted within five business days from the record date on which the obligation arises (twice or more a month) (Special Reporting System).
- (2) Subsequent reporting obligation
 - After a Large Volume Holder submits the Report of Possession of Large Volume, if its holding ratio of share certificates, etc. increases or decreases by 1% or more, it submits the Change Report addressed to the Prime Minister within five days, as a general rule, from the date of the aforesaid increase or decrease, and sends copies of the Change Report to the stock exchange and the issuing company.
 - The party that has submitted the Report of Possession of Large Volume or the Change Report of Possession of Large Volume submits the Correction Report to the Prime Minister if any deficiency was found with the content of the report initially submitted.
- (3) Public inspection of reports
 - The Prime Minister and stock exchanges disclose the reports for public inspection for a period of five years.

Note: Effective from April 2007, the reports are required to be submitted via EDINET.

chased, purchase period, etc.; (2) submit the Tender Offer Notification; (3) issue the Tender Offer Statement, a document explaining the TOB, to applying shareholders; and (4) report the results of the TOB after the completion of the purchase period. In order to prevent the use of TOB for market manipulation or abuse, cancellation of TOB is prohibited as a general rule, and certain restrictions apply for making changes to the terms of purchase. Meanwhile, information on the views of the target company regarding the TOB is extremely important for shareholders in judging whether or not to accept the tender offer. For this reason, the target company of a TOB must immediately submit its Position Statement addressed to the Prime Minister.

While the act of purchasing a large amount of share certificates, etc. in itself does not immediately cause a problem, it can, in many cases, cause fluctuations in stock prices or influence the controlling interests of the company concerned and may lead to inflicting damage on general investors. In consideration of such possibilities, any person or entity, if it becomes a holder of more than 5% of the shares or other equity securities of a listed company, etc., is required to file a Report of Possession of Large Volume to the Prime Minister. In addition, such a person or entity, after having become a Substantial Shareholder, is required to file a Change Report Pertaining to Report of Possession of Large Volume addressed to the Prime Minister if its shareholding ratio in the entity covered by the aforesaid Report increases or decreases by 1% or more or there is a material change to any other entry in the Report. The Reports of Possession of Large Volume and Change Reports are publicly disclosed. This system was put in place with the aim of further protecting investors by encouraging timely and accurate disclosure of information on large-scale purchases and on holding and secondary offering of shares, etc. to investors and promoting high fairness and transparency in the securities market.

CHAPTER XVI

The Information Disclosure System and Investor Protection

1. The Information Disclosure System in the Securities Market

When a company lists its security on the financial instrument market opened on a stock exchange, the issuer of such security is required by the Financial Instruments and Exchange Act and by the rules of the stock exchange to disclose information concerning certain matters of its business. Such rules are called disclosure requirements, and they consist of statutory disclosure rules under the Financial Instruments and Exchange Act and the timely disclosure required by the securities exchanges.

There are four types of statutory disclosures that the issuers of securities are required to make: (1) issuance disclosure, which requires companies to disclose information concerning certain matters when they publicly offer securities on the primary market; (2) periodic disclosure, which requires companies whose securities are listed and traded on the securities market to disclose information concerning certain matters on a continuing and regular basis; (3) tender offer disclosure; and (4) large volume holding disclosure (shareholdings of 5% or more). The latter two types of statutory disclosure are required under the Financial Instruments and Exchange Act. On the other hand, timely disclosure, which is required by the stock exchanges, obliges companies to continuously disclose their information after listing their securities on the exchanges, and the type of information required is classified into (1) information on listed companies; (2) information on subsidiaries, etc.; and (3) other information, such as supplemental information on majority shareholders, etc. Information is categorized as (1) decisions made, (2) occurrences, and (3) information on financial results. At present, both statutory and timely disclosures are made via an electronic disclosure system using the Internet. Statutory disclosure is made via the EDINET (Electronic Disclosure of Investors' NETwork) while timely disclosure is made using the TDnet (Timely Disclosure network).

Companies that are required to make issuance disclosure and periodic disclosure are also required by the Companies Act to disclose certain informa-

Chart XVI-1. The Scheme of the Disclosure System on the Securities Market

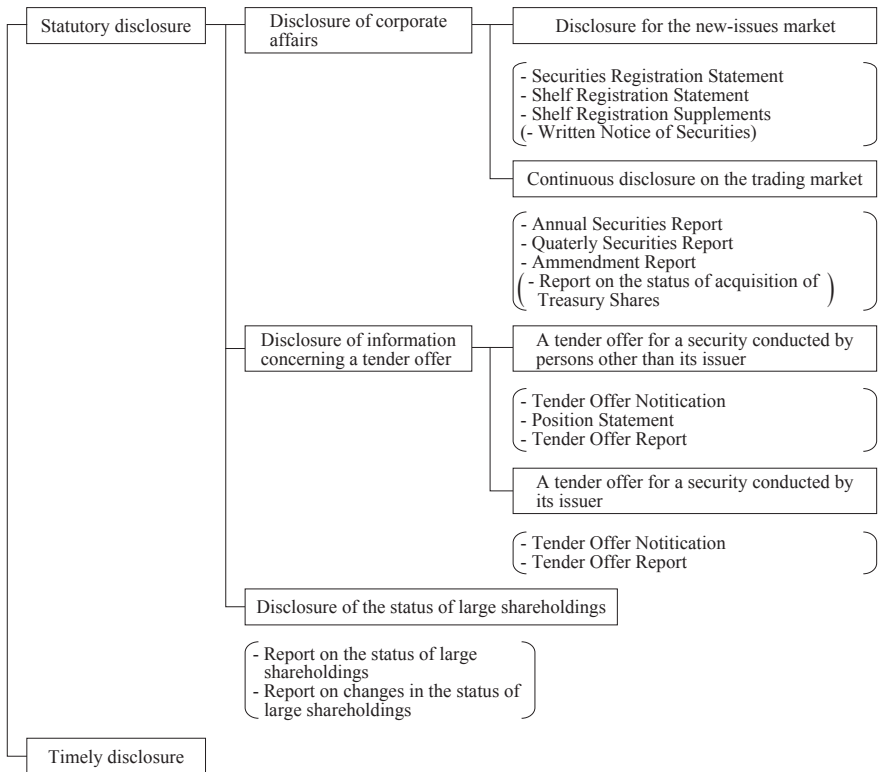


Table XVI-1. Disclosure Systems under the Companies Act and under the Financial Instruments and Exchange Act

Disclosure System under the Financial Instruments and Exchange Act		Disclosure System under the Companies Act
Furnishing information necessary for investors to make an investment judgment	Purpose of disclosure	Report on profits available for dividends and the company's capacity for offering security for loans (solvency)
Investors (including those who are not shareholders of the company at a given time)	Targets for which the disclosure is intended	Shareholders and creditors
Providing disclosure through EDINET and stock exchanges, replying to investor requests for disclosure	Method of disclosure	Preparation of computing documents, keeping of such documents at the head office, and publication of a summary of annual settlement of accounts

tion. The disclosure of accounting documents required to be made by the Companies Act is aimed at protecting the interest of shareholders and bondholders and at regulating the amount that can be paid in dividends. In contrast, the disclosure required to be made under the Financial Instruments and Exchange Act and under exchanges' regulations is designed to disclose information concerning the state of business of listed companies to help the investors to make informed and reasonable investment decisions.

2. The System of Disclosing Corporate Information under the Financial Instruments and Exchange Act

Issuance Disclosure

When a company publicly offers, or makes a secondary distribution of, a security whose aggregate value is ¥100 million or more, the issuer of such security must, in principle, file a securities registration statement with the Prime Minister. On the primary market, information is disclosed through the securities registration statement submitted. The statement shall describe (1) matters pertaining to said offering or secondary distribution, (2) the trade name of the issuing company, (3) the name of the business group to which it belongs, (4) the financial position of the issuing company, and (5) important information on other material matters concerning its business. In addition, when a securities company solicits customers for the purchase of a newly issued security, it is required to provide investors with a prospectus that furnishes them with information concerning the issue that is deemed necessary for them to assess its value and to make an informed investment decision.

Periodic Disclosure

The issuer of securities listed on an exchange must file with the Prime Minister an annual securities report for each business year within three months after the expiration of such business year. The annual securities report constitutes the main document of statutory disclosure for the secondary market. More specifically, it must provide (1) the name of the issuer, (2) the name of the business group to which it belongs, (3) information concerning the state of its finances, and (4) information on other material matters concerning its business. Moreover, companies that are required to make periodic disclosure must regularly file quarterly securities reports, extraordinary report, and share buyback report where necessary.

Issuers of securities that are traded on the financial instruments market are expected to disclose sufficient information concerning their corporate affairs, on the basis of which the prices of securities will be formed. If they do not disclose information that is to their disadvantage, the prices of their securities

Table XVI-2. Statutory Disclosure Documents Required to be Filed

Classification	Documents filed	Cases requiring the filing of documents (a summary)
Disclosure of corporate affairs, etc.	Issuance Disclosure	<p>If a company issuing new shares or making a secondary distribution of shares through an offering whose total issuing or secondary distribution price is ¥100 million or more plans to solicit 50 or more investors for the purchase of its new shares or plans to sell to or solicit 50 or more investors for the secondary distribution on uniform terms and conditions, it must file a registration statement.</p> <p>* Small amount offering: In the case of a company issuing new shares or making secondary distribution of shares through an offering whose total issuing or secondary distribution price is less than ¥500 million the contents of the securities registration statement required to be filed by such company are simplified.</p> <p>* Incorporating system: A company that has been filing Annual Securities Reports continuously for one year may substitute a securities registration statement other than matters relating to the offering or secondary distribution of securities with the annual securities report and quarterly securities reports filed in its place.</p> <p>* Reference system: When transactions of issued securities fulfill certain requirements of the securities market with which the issuer has been filing Annual Securities Reports for a year and the issuer's corporate information has broadly been disclosed, the description that one should refer to the last Annual Securities Reports, etc., may be substituted with a securities registration statement concerning matters other than the offering or secondary distribution of securities.</p>
		<p>When any issuer who is authorized to file a securities registration statement under the reference system plans to issue new shares or make a secondary distribution of shares through an offering whose total issuing or secondary distribution prices are ¥100 million or more, such issuer may file a shelf-registration statement of its shares.</p>
		<p>When a shelf-registration statement of a security has taken effect, and when the issuer of such security plans to issue new shares or make a secondary distribution of shares whose total issuing or secondary distribution prices are ¥100 million or more, such issuer is required to file supplementary documents relating thereto.</p>
	Periodic disclosure	<p>Any company that is (1) the issuer of a security to be listed on a stock exchange; (2) the issuer of securities stipulated by cabinet order as that similar to distribution conditions in (1); (3) the issuer of a security who is required to file a securities registration statement when it issues new shares or makes a secondary distribution of shares through an offering; or (4) the issuer of a security the number of whose owners was 1,000 or more at the end of any of the latest five years (excluding certain cases), is required to file a securities report.</p>
		<p>Among companies required to submit Annual Securities Reports, issuers of securities listed on stock exchanges or stipulated by cabinet order as being similar in terms of distribution conditions must file quarterly securities reports.</p>
		<p>If any material fact has occurred in a company submitting Annual Securities Reports.</p>
		<p>Any issuer of a security listed on a stock exchange or stipulated by cabinet order as being similar in terms of distribution conditions and that has passed a resolution at a general meeting of its shareholders or at a board of directors' meeting to acquire its own shares must file a report.</p>

will be formed on the basis of an erroneous assessment of their value that does not reflect such withheld information. This is why the law requires the issuers of securities to periodically disclose all pertinent information, good or bad, in their annual securities reports, and why it contains penal provisions to discipline issuers who file an annual securities report containing false statements.

3. Other Disclosures to Be Made under the Financial Instruments and Exchange Act

Disclosure Relating to a Tender Offer

The act of soliciting an unspecified large number of persons through a public notice for an offer to purchase or to sell shares and of purchasing such shares off of the exchange is called a “tender offer.” If any person other than the issuer of a listed stock who is required to file an annual securities report proposes the purchase of such shares outside the market of a stock exchange, he must, except in cases that fall within the purview of certain requirements, such as the purchase will result in the ownership of more than 5% of the securities, etc., purchase such shares through a tender offer. The tender offerer is obligated to serve a public notice of (1) the purpose of the tender offer; (2) the purchase prices, etc.; (3) the number of stocks to be purchased; (4) the period during which stocks will be purchased; and (5) other items stipulated in other cabinet ordinances (“public notice for commencing tender offer”) and must also file the tender offer notification with the Prime Minister. In addition, the tender offerer must, on the day immediately following the day on which the tender offer period has expired, serve a public notice or make an announcement indicating the number of shares offered to sell, the number of shares it has actually purchased, and the method of payment to be made to sellers and file with the Prime Minister a tender offer report furnishing information about such matters.

The regulation on tender offers is designed to disclose information for investors in advance and give shareholders equal opportunities to sell their stocks from the standpoint of ensuring the transparency and fairness of off-exchange trading when the transactions would have effects on the control of the target corporation.

Disclosure of Status of Large Volume Holding of Share Certificates, etc.

When the number of shares of a listed company held by a person exceeds 5% of its outstanding shares (large-volume holders), such person is principally required to file a Report of Possession of Large Volume with the Prime Minister within five days (excluding Sundays and other holidays as may be stipu-

Table XVI-3. Transitions in Tender Offer Bid (TOB) System

	Major Developments
1971	<ul style="list-style-type: none"> • Public tender offer system introduced
1990	<ul style="list-style-type: none"> • Principles set down for forcing tender offers • Percentage share offer that triggers obligation to make tender offer decreased (from 10% to 5%) • Prior notification system abolished • Duration of offer extended • Shareholders' withdrawal rights expanded
2001	<ul style="list-style-type: none"> • Along with the deregulation, in principle, of purchasing treasury shares, system for making tender offers for a company's own shares introduced
2003	<ul style="list-style-type: none"> • Scope of acquisitions exempt from the TOB system enlarged
2004	<ul style="list-style-type: none"> • TOBs restricted to companies with equity securities • Electronic notification system introduced
2005	<ul style="list-style-type: none"> • ToSTNeT transactions made independent of market transactions
2006	<ul style="list-style-type: none"> • Disclosure for TOBs upgraded (purpose of acquisition, basis of price calculation, disclosure for MBOs) • Regulations implemented concerning the combined acquisition of shares on and offmarket • Obligation introduced for investors acquiring a large stake in a company during TOB by another party to also make a TOB • Acceptance for lowering TOB price when share split occurs • Reasons for withdrawing TOB expanded • Obligation introduced for targeted company to submit a Position Statement • Obligation introduced for investor making TOB to answer targeted company's questions (reply to submitted questions) for the purpose of submitting a Position Statement • Calculation of duration of TOB set using business days • Targeted company allowed to demand extension of TOB • Obligation introduced for TOB investor to acquire all tendered shares
2008	<ul style="list-style-type: none"> • Specified listed securities added to securities eligible for TOBs • Monetary surcharge system introduced regarding TOB rules

lated in cabinet orders) from the date when such person's holding rate is above 5% (called the "5% rule"). The Report of Possession of Large Volume must furnish information concerning (1) matters relating to the ratio of shares held by such person, (2) matters relating to the funds acquired by such person for the purpose of purchasing such shares; and (3) the purpose for which such person has acquired such shares. And when the percentage of shareholdings of such person who must submit the report increases or decreases by 1% or more, such person must file a Change Report indicating the change that occurred in the percentage of such person's holdings of such shares. This disclosure is required because the actions of a single person holding a large volume of shares can have large effects on the formation of stock prices at the market.

4. Timely Disclosure System of Financial Instruments Exchange (Stock Exchange)

As described at the start of this chapter, stock exchanges require listed companies to disclose corporate information according to their rules. For example, the Tokyo Stock Exchange stipulates in the rules of the exchange governing the listing of securities that listed companies shall, in a timely fashion, disclose information having effects on investors' decisions and defines concrete matters to be disclosed and procedures for disclosing such matters (see Table XVI-4). These listed companies need to disclose both the resolutions and decisions adopted by their executive body promptly after such resolutions or decisions were adopted and any developments caused by external factors at the time the companies had learned of such developments.

Promptness is a feature of timely disclosure. For example, stock exchanges require listed companies to disclose their financial results immediately after their determination. In response, the listed companies disclose earnings reports (*kessan tanshin*) according to the given format. The earnings report carries more importance in terms of helping investors to learn about financial results because it is released earlier than the annual securities report.

In addition, listed companies are obliged to provide stock exchanges with concise information on inquiries from the stock exchanges immediately if required and to disclose the details of information immediately when the securities exchanges deem it necessary and proper. For example, in the case where there is a broadcast or rumor regarding corporate information but the accuracy of such information is unconfirmed, the stock exchange concerned may make a query to the company about the accuracy of information and require the company to disclose the response to such query.

The Tokyo Stock Exchange has put in place a system for issuing alerts where if the TSE identifies any unclear piece of information among the information about a listed company that can have a material impact on investment decisions of investors and the listed company requires time before offering proper information disclosure regarding the aforesaid unclear piece of information or can disclose only certain information immediately, the TSE issues an alert to investors.

5. Ensuring the Appropriateness of Information Disclosure

In order to ensure the effectiveness of securities listing requirements, including rules on timely disclosure, stock exchanges may implement prescribed measures against violations found, such as when the disclosed information

Table XVI-4. Main Points of Corporate Information Required by Timely Disclosure (in the case of the Tokyo Stock Exchange)

1. Decisions by Listed Companies	<ol style="list-style-type: none"> Offering of new shares to be issued, treasury shares to be disposed of, issued subscription Rights/warrants, or offering to entities who will subscribe to treasury subscription rights/warrants to be disposed of, or a secondary distribution of shares or subscription rights/warrants Self-registration and the commencement of a demand survey Decrease in amount of capital Decrease in amount of capital reserve or profit reserve Acquisition of one's own stock Gratis allotment of shares or gratis allotment of subscription warrants Self-registration concerning gratis allotment of subscription rights/warrants or commencement of a demand survey or a survey on intention to exercise the warrants Share split or reverse share split Issue of stock options Dividend from surplus Share exchange Share transfer Merger Demerger Takeover bid or take over bid for own shares Announcement of opinions about a takeover bid, etc. Transfer or acquisition of all or part of a business Dissolution (excluding dissolution by means of merger) Commercialization of a new product or new technology Business alliance or dissolution of business alliance Transfer of shares or equity interest accompanied by a change in a subsidiary or other matters accompanied by a change in a subsidiary Transfer or acquisition of fixed assets Lease of fixed assets Suspension or abolishment of all or part of a business Application for delisting Petition for commencement of bankruptcy, commencement of rehabilitation proceedings, or commencement of reorganization proceedings Commencement of a new business Change in representative directors or representative executive officers Rationalization such as personnel reduction Change in a trade name or a corporate name Change in the number of shares for a share unit of a stock, or abolition/introduction of provisions for the number of shares for a share unit Change in accounting period (change in the end date of the business year) Petition to the Prime Minister stating an excess of liabilities or possibility of the halt of repayment of deposit, etc. (petition under the provisions of Article 74, Paragraph 5 of the Deposit Insurance Act) Petition for mediation in accordance with specified mediation procedures pursuant to the Act on Specified Mediation for Promoting Adjustment of Specified Liabilities, etc. Important matters related to rights pertaining to listed bonds Change in certified public accountants, etc. Putting notes on matters related to the going concern assumption Submission of application for approval of deadline extension for submission of annual securities report or quarterly securities report Cancellation of entrustment of shareholding services to a shareholding service proxy institution Submission of internal control reports containing content to the effect that there is a material deficiency or that the evaluation result cannot be stated Amendment to the articles of incorporation Acquisition of all classified stocks subject to whole acquisition clause Approval or rejection of a special controlling shareholder's request for sale of shares, etc. Other important matters related to listed company operations, business, assets, or listed company stock certificates, etc.
2. Facts which Occurred for a Listed Company	<ol style="list-style-type: none"> damage arising from a disaster or in the performance of its operations Change in major shareholders or the largest shareholder Fact which causes delisting Filing of a lawsuit or a court decision Petition for a provisional disposition or decision on such petition, etc. Cancellation of a license, suspension of a business or any other disciplinary action corresponding to these on the basis of laws and regulations by an administrative agency or accusation of violation of laws and regulations by an administrative agency Change in a parent company, change in controlling shareholders (excluding a parent company) or change in other related company Petition or notification for commencement of bankruptcy proceedings, commencement of rehabilitation proceedings, commencement of reorganization proceedings, or execution of enterprise mortgage Dishonor of a bill or check or suspension of trading by a clearing house Petition for commencement of bankruptcy proceedings, commencement of rehabilitation proceedings, commencement of reorganization proceedings, or execution of enterprise mortgage pertaining to a parent company, etc. Default on obligations or delay in collection Suspension of trade with a business partner Financial support, such as exemption of obligations Discovery of natural resources Special controlling shareholder's request for sale of shares, etc. Claim for suspension of issue of stock or subscription rights/warrants General for convocation of a general shareholders' meeting Unrealized loss of securities held Acceleration of obligations pertaining to a corporate bond Convocation of a bondholders' meeting for a listed bond, etc. and other important facts pertaining to rights of a listed bond, etc. Change in certified public accountants, etc. Delay in submission of annual securities report or the quarterly securities report Approval, etc. of deadline extension for submission of the annual securities report or quarterly securities report The fact that an audit report attached to financial statements, etc. contains an "adverse opinion", "opinions are not expressed", or a "qualified opinion" with making issues concerning a going concern assumption as exceptions An internal control audit report contains an "adverse opinion" or the fact that "opinions are not expressed" Receipt, etc. of a notice of canceling a shareholder services agent agreement Other important matters related to operation, business or assets of such listed company or related to a listed stock certificates, etc.
3. Listed Company Earnings Information	<ol style="list-style-type: none"> Earnings reports (kessan tanshin), quarterly earnings reports (shihanki kessan tanshin) Amendments to performance estimates, differences in estimates and earnings values Amendments to dividend estimates, etc.

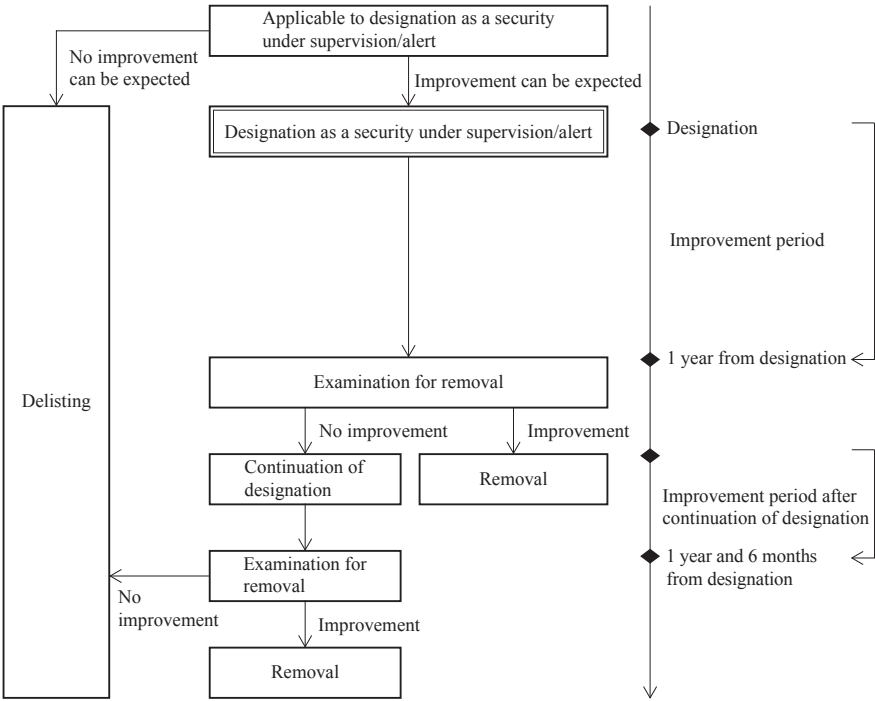
Note: In addition to the above, listed companies are required to disclose important decisions and new developments related to subsidiaries and other matters relating to controlling shareholders, etc.

Source: Tokyo Stock Exchange, *Securities Listing Requirements, Guidebook for the Timely Disclosure of Corporate Information*.

Table XVI-5. Measures to ensure effectiveness

○ Penalty measures	○ Improvement measures
• Methods of announcing information	• Improvement Report, Improvement Status Report
• Penalty on breach of the listing contract	• Designation as Securities on Alert

Chart XVI-2. Flow from Designation as Securities Under Supervision/Alert to Removal of Designation



Note: If it is found during the period of designation that no improvement can be expected, the security is delisted.

contains false statements or when there is a violation of matters to be observed under the Code of Corporate Conduct. These measures to ensure the effectiveness are classified into two categories: improvement measures and penalties. The former requires the listed company concerned to make improvements while the latter imposes a penalty on the listed company.

Improvement measures are categorized into the designation as a security

under supervision/alert and the submission of Improvement Report/Improvement Status Report. For example, if a listed company has made a false statement in its securities report, etc. and a stock exchange recognizes that there is a strong need for the listed company to make improvements to the company's internal management system, etc., the listed company is designated as a "security under supervision/alert." The designation as a security under supervision/alert is removed if the listed company makes improvements to its internal management system, etc. within the prescribed period for improvement. If, however, no improvement is made within the prescribed period or there is no likelihood of improvement, the company will be delisted. The securities on alert system is a mechanism for having the listed companies concerned make proper improvements while removing the possibility of delisting in the future, and has been introduced as a measure equivalent to delisting. If it is found that there is difficulty in maintaining order on the market unless a stock is immediately delisted, such stock is delisted without receiving the designation as a security under supervision/alert.

Meanwhile, if a stock exchange finds that there is a strong need for a listed company to make improvements even when the status of the listed company does not correspond to giving designation as a security under supervision/alert, which is a measure leading to possible delisting, the stock exchange may require the listed company to submit an Improvement Report containing the circumstances behind the misconduct and improvement measures. The listed company that has submitted the Improvement Report must submit an Improvement Status Report containing the status of implementation and operation of improvement measures in a timely way after six months have passed since the submission of the initial Improvement Report. The Improvement Report and the Improvement Status Report submitted by the listed company concerned are made available for public inspection on the website of each stock exchange.

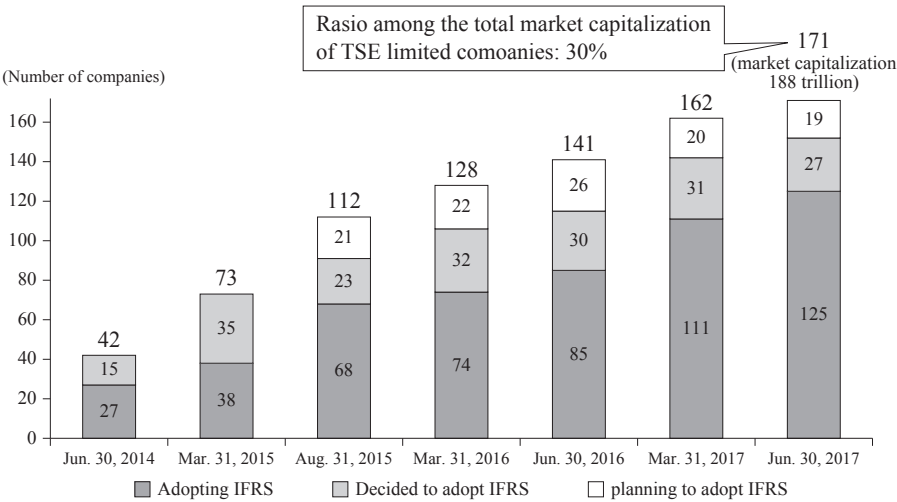
Meanwhile, penalties are categorized into a penalty (a fine) against a breach of listing contract and a disclosure measure. Depending on the degree of damage given to the trust that shareholders and investors place in the market, a judgment will be made on whether to apply the penalty (a fine) against a breach of contract, which is the more serious treatment.

6. Recent Moves of Information Disclosure

Movement toward Introduction of International Financial Reporting Standards (IFRS)

International Financial Reporting Standards (IFRS) are accounting standards developed by the International Accounting Standards Board (IASB).

Chart XVI-3. Number of Companies Adopting IFRS on the TSE



In total, over 100 countries now use or plan to use the IFRS as their own accounting standards. In the EU, companies listed in the region have been required to use the IFRS since 2005. And financial statements prepared based on the IFRS are accepted in the United States.

Also in Japan, since 2010, listing companies have been allowed to voluntarily adopt the IFRS on condition, among other requirements, that the companies conduct international financial or business activities. However, in fact, only a few companies took advantage of this option. Under such circumstances, in 2013, with a view to expanding voluntary adoption of the IFRS, the requirements were relaxed. In addition, given the recommendations proposed by the government in its growth strategy, initiatives were taken toward expanding the scope of application, including the release of a report by the FSA in 2014 that summarized the objectives of companies pursuing voluntary adoption of the IFRS at the time of shifting to the IFRS and the advantages of adopting the IFRS. Currently, there are 171 companies listed on the TSE that have either already adopted the IFRS or are scheduled to adopt the standards. These companies account for 30% of the overall market in terms of market capitalization.

Introduction of the Japanese-Version Fair Disclosure Rules

In April 2018, a bill amending the Financial Instruments and Exchange Act to include the Fair Disclosure Rules was enacted. The Fair Disclosure Rules are referred to as the rules which ensure that when a listed company, etc. pro-

Table XVI-6. Outline of the Japanese-Version Fair Disclosure Rule

Target information range	<ul style="list-style-type: none"> • Important information that influences investment decisions • Basically consistent with the scope of information subject to insider trading regulations • Of other above information, it is included information that is unpublished definitive and affected to the price of issuer securities when published • Mosaic information that does not influences investment decisions immediately itself is not eligible.
Target of information providers	<ul style="list-style-type: none"> • In addition to the officers of the issuer, employee or servant or an agent (limited to the person that communicates information to recipient)
Target of information recipients	<ul style="list-style-type: none"> • Suppliers to provide information related to trading results of securities and financial results analysis results, etc. to third parties, that is securities companies, investment managers, investment advisers, investment corporations, credit rating agencies, etc. • The person that it is assumed that the issuer securities are bought and sold based on information to be provided by the issuer
Provision of information that does not require publication	<ul style="list-style-type: none"> • Do not need publication if the information recipient assume an obligation that the information recipient concerned does not transmit to a third party, and does not use it in an investment judgment even if it is the offer to an information recipient targeted for the rule. • When an information provider grasps that an information recipient transmitted information to others targeted for the rule in violation of obligation of keeping secrecy, publication of the information is required by the issuers.
Publication method of information	Providing disclosure through EDINET, Timely disclosure through TD-net, and Publication on the issuer's home page
Enforcement	<ul style="list-style-type: none"> • At first, pressing the issuers for prompt publication of the information when it conflicts with this rule. • And so, when appropriate correspondence does not have it stolen by this. instructions giving it an order to start the effect of this rule by administrative.

Source: Produced on Financial Services Agency publication "council for finance market working group fair disclosure rule taskforce report"

vides inside information which might have an impact on investment decisions to a specific third party, such as an analyst of a securities company or a fund manager of an investment management institution, such information also be equally disclosed to other investors. According to a report released by the Task Force on Fair Disclosure Rules, the scope of such information should, in principle, correspond with the scope of information which triggers Japan's insider trading regulations but should also include non-public information of a precise nature concerning an issuer which would likely have a material effect on the price of the issuer's securities if made public.

CHAPTER XVII

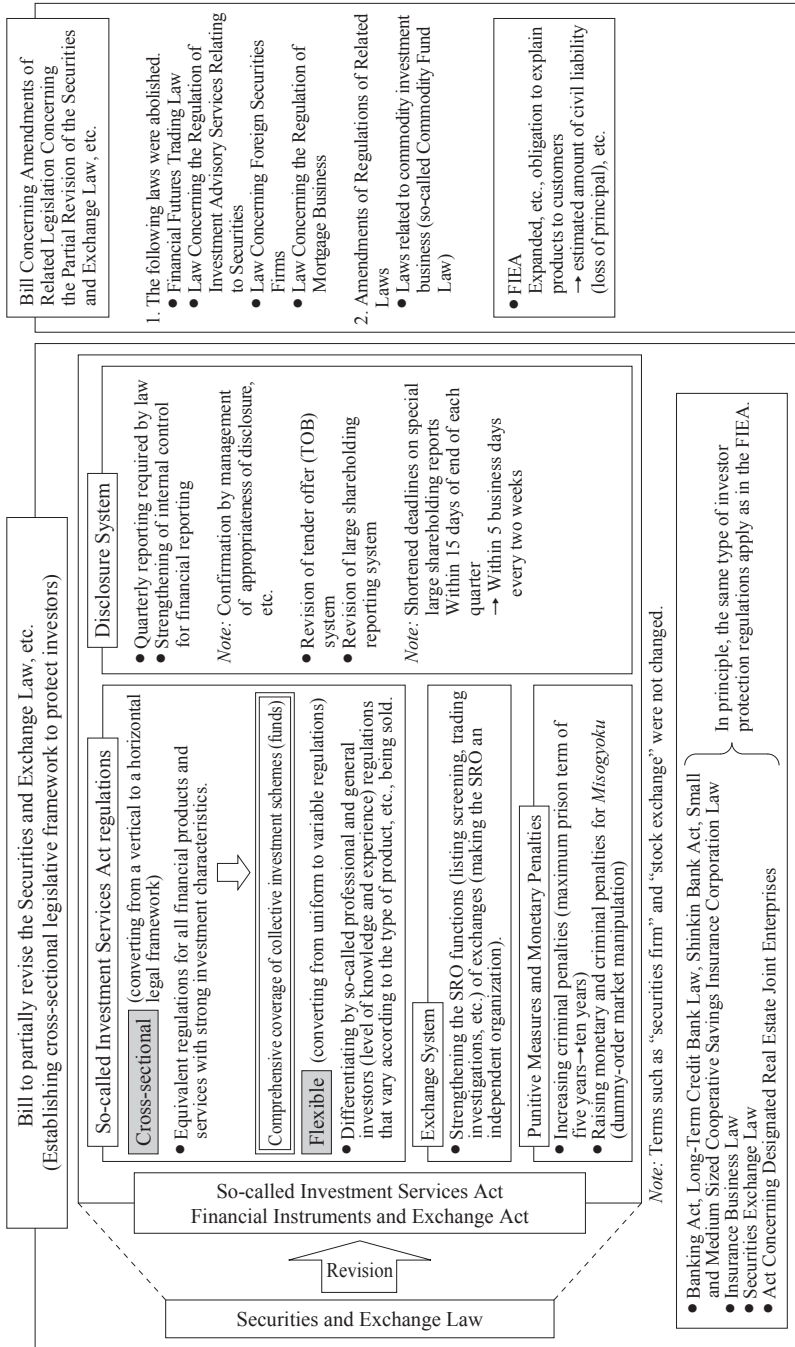
The Securities Regulatory System

1. Financial Instruments and Exchange Act

In 2006, the Securities and Exchange Act underwent major revisions and was renamed the Financial Instruments and Exchange Act (FIEA). These revisions were enforced for the purpose of introducing cross-sectional regulations and flexibility into the financial system. Introduction of cross-sectional regulations meant revising the conventional vertically segmented regulations and applying the same types of rules to financial instruments with similar economic functions and risks. This was achieved by expanding the FIEA's scope of application and by revising various related laws and regulations. More specifically, the scope of application was extended to include not only general investment trust beneficiary rights and mortgage securities, etc. but also collective investment schemes, making it possible to implement regulations comprehensively. In addition, various related laws were revised to establish a regulatory framework where financial instruments not covered by the FIEA but sharing many of the same aspects were subject to similar rules. Another move to cross-sectional application was the standardization of the registration of sales and solicitation, investment advisory, asset management, and asset administration, etc., businesses under the umbrella of Financial Instruments Business Operators with the aim of applying as common a code of conduct as possible.

The authorities introduced flexibility into the law through (1) disclosure regulations, (2) industry regulations, and (3) separating rules for dealing with different classes of investors. More specifically, (1) they placed strict disclosure obligations on highly liquid securities, strengthening the disclosure system by requiring listed companies to provide quarterly securities reports, internal control reports, and confirmation letters from auditors. In contrast, illiquid securities, in principle, are exempt from these disclosure regulations. (2) While all Financial Instruments Business Operators are required to register under the comprehensive industry regulations, businesses are classified into the three categories of Type I and Type II Financial Instruments Businesses, Investment Advisory and Agency Business, and Asset Management

Chart XVII-1. Transition from Securities and Exchange Act to Financial Instruments and Exchange Act



Source: Materials produced by the FSA.

Business, with separate rules applying for each category. In addition, (3) customers are classified into professional investors and general investors, with various exceptions to the general industry code of conduct applying to dealing with professional investors.

Major revisions to the FIEA included those relating to firewall regulations between securities companies, banks and insurance companies enforced in 2008, the introduction of public regulations on credit-rating agencies, establishment of the Alternative Dispute Resolution (ADR) System in the financial sector, establishment of a framework for alliances among financial instruments exchanges and commodity exchanges that went into effect based on the revisions in 2009, and the introduction of a disclosure system relating to rights offering that was made based on the revisions enforced in 2011. Subsequently, in the 2015 revision, regulations on funds for professionals (specially permitted businesses for Qualified Institutional Investor, etc.) were amended. And the most recent 2017 amendments included (1) the introduction of rules on high-speed trading (HST) where a registration system for high-speed traders was adopted along with a call for the establishment of an operation management system; and (2) the introduction of the Fair Disclosure Rules.

2. Other Laws and Regulations Related to the Securities Market

While the Financial Instruments and Exchange Act (FIEA) serves as the most fundamental law concerning securities, securities business operators, and transactions on the securities markets, there are, in fact, many other related laws and regulations.

As previously stated, in addition to the enforcement of the FIEA, from the point of view of investor protection, other laws were revised so that they shared, to the extent possible, common regulations with the FIEA for financial instruments not covered by the FIEA but having the same economic function. For example, such related laws as the Banking Act (Art. 13-4), Insurance Business Act (Art. 300-2) and the Trust Business Act (Art. 24-2) implemented provisions equivalent to the FIEA's code of conduct, perhaps the most important area for customer protection. Specifically, these laws have regulation of advertising, etc.; obligation to clarify conditions of transactions in advance; delivery of document prior to conclusion of contract; behavior prohibitions; prohibition of compensations of loss, etc.; and best execution policy.

The Act on Sales, etc. of Financial Instruments was formulated to provide cross-sectional regulations regarding the sale and solicitation of sales for deposits, investment trusts, insurance, securities, and other financial instru-

Table XVII-1. Banking Act, Insurance Business Act, and Trust Business Act

1. Acts that have sales and solicitation rules equivalent to those of the FIEA for deposits, insurance policies, and investment trusts with strong investment characteristics

(Points of view on which regulations have been implemented for each act)

	Banking Act (specified deposits, etc.)	Insurance Business Act (specified insurance policies, etc.)	Trust Business Act (specified trust agreements)
Advertising, etc. regulations	<ul style="list-style-type: none"> In the case of derivative deposits, if the bank has the right to extend the term of the deposit, it must indicate to the customer the risk that the interest rate could fall below the market rate to the disadvantage of the customer. 		
Obligation to deliver written documents	<ul style="list-style-type: none"> Exceptions to the obligation to deliver written documents <ul style="list-style-type: none"> When a document on foreign currency deposit, etc. was delivered within the past year When a similar document was delivered within the past year <i>Note:</i> Establish transitional measures at the time of enforcement (can be issued prior to enforcement; can be issued within three months of enforcement) In the case of derivative deposits, the document prior to conclusion of contract must contain the same contents as the items shown in the advertisement, etc. 	<ul style="list-style-type: none"> The document prior to conclusion of contract must contain notes on material items in accordance with provisions in supervisory guidelines regarding the contract outline and cautionary information Eg.: The contract outline is dictated on the statutory level, while cautionary information is dictated on the cabinet office order level. Items covered in the document delivered upon conclusion of contract can be adjusted in line with the items included in the insurance policy, etc. Eg.: Items regarding the type and content of the contract can be omitted from the document delivered upon conclusion of contract if they are contained in the insurance policy, etc. 	<ul style="list-style-type: none"> Exceptions to the obligation to deliver the document prior to conclusion of contract (Documents regarding a similar contract has previously been delivered, and the customer has made it clear that issuance of documents is not necessary, etc.)
Prohibited acts	<ul style="list-style-type: none"> Generally prohibited acts in the banking business Concluding a contract without adequate explanation necessary for understanding the document prior to conclusion of contract or the document on foreign currency deposits, etc. 	<ul style="list-style-type: none"> Generally prohibited acts for concluding or soliciting purchase of insurance policy Concluding a contract without adequate explanation necessary for understanding the document prior to conclusion of contract 	<ul style="list-style-type: none"> Generally prohibited acts in underwriting trusts Concluding a contract without adequate explanation necessary for understanding the document prior to conclusion of contract
Specified investors (Tokutei Toushika) (Type of contract)	<ul style="list-style-type: none"> One type (contract for specified deposits, etc.) 	<ul style="list-style-type: none"> One type (contract for specified insurance policies, etc.) 	<ul style="list-style-type: none"> One type (contract for specified trusts)

2. Business scope of banks and insurance companies (Auxiliary businesses)

- Expanded to include agency or intermediary business for concluding investment advisory and discretionary investment contracts (banks only).
- Expanded to include emission rights derivatives trading. (intermediary and consulting services for emission rights trading also permitted as incidental businesses).

3. Business scope of banking and insurance company subsidiaries

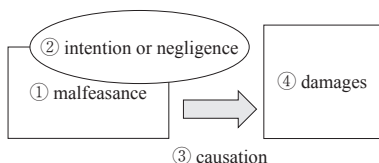
- Business scope of securities subsidiaries expanded (full coverage of Financial Instruments Businesses).
- Scope of financial-related businesses expanded (private placements, investment advisory and agency business, self-management, emission rights trading, emission rights derivatives trading, etc.).

Source: The FSA.

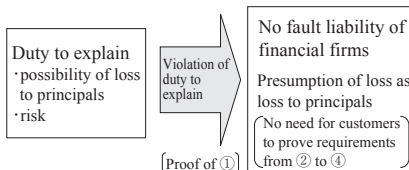
Chart XVII-2. Enhancement of the Act on Sales, etc. of Financial Instruments

Principles on actions for damages under civil act (section 709 of the Civil Law)

Customers (sufferers) shall prove all the requirements from ① to ④ to win actions for damages against financial firms.

Financial Products Sales Act

The act prescribes special treatment on actions for damages regarding a wide range of financial products, including deposits, insurance, securities, etc.

Strengthening Financial Products Sales Act

- Enlarging the scope of duty to explain
 - Adding a possibility of losses beyond original principals and important part of schemes of financial instruments in the scope of duty to explain
- Introducing prohibition of provision of conclusive judgment
 - no-fault liability and presumption of loss in case of the violation

Source: The FSA.

ments. The law was revised in 2006 at the same time the FIEA came into force to make it easier for customers to press civil liability suits. For example, the law expanded the scope of obligation to explain products to customers (Article 3, Paragraph 1, Items (ii), (iv) and (vi)) and added a suitability rule (Article 3, Paragraph 2). These revisions defined the responsibility, in the case of a violation of the suitability rule, to compensate the customer for damages, which are presumed to be any loss of principal (Article 6). The Commodity Exchange Act (currently the Commodity Derivatives Transaction Act) was also reformed to include similar regulations for its financial instruments. The revisions implemented advertising regulations and inserted an obligation to explain financial products in a manner appropriate to the customer. Furthermore, loss compensation was prohibited and made punishable by penalties.

While most of the business and code of conduct regulations regarding the investment trust intermediary business and asset management business of investment corporations have been included in the FIEA, the Act on Investment Trusts and Investment Corporations (Investment Trust Act) was left to focus solely on investment trust regulations and to serve as one of the pillars of investment trust regulations along with the FIEA.

There are several laws pertaining to issuance of securities. For example, issuing of public bonds is approved based on the provisions of the Public Fi-

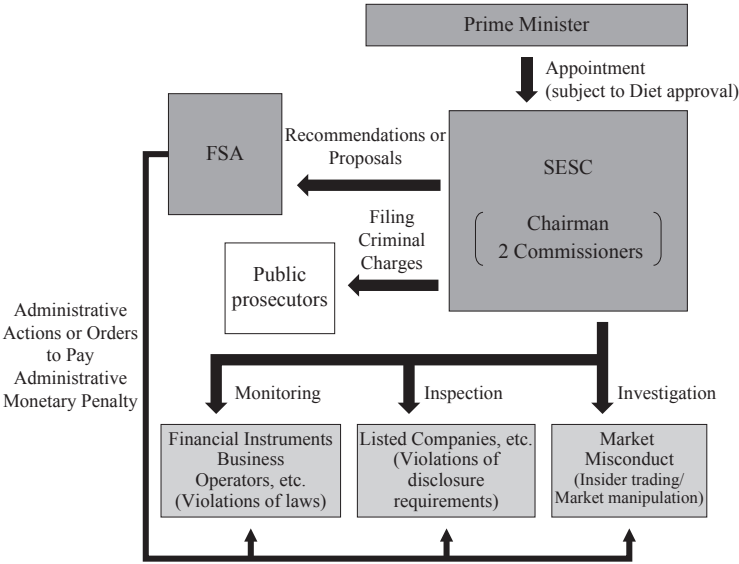
nance Act and the Local Government Finance Act while deficit-covering bonds are governed by the special law of each fiscal year (legislation is not required up until fiscal 2020 based on the Special Bond Act of 2016). There are also laws concerning issuing administration for government bonds. For private securities, the Companies Act provides for the issuance of stocks and corporate bonds by corporations. As for corporate bonds and other bonds, the Secured Bond Trust Act and the Enterprise Mortgage Act are separately enforced in regard to collateral. In addition, the Act on the Securitization of Assets is in place regarding the issuance of asset-backed securities.

3. Organization of the Securities Regulatory System

During the period after the war, the Securities and Exchange Act was in place and the Securities and Exchange Commission, which was modeled after the U.S. Securities and Exchange Commission (SEC) and established as an external bureau of the Ministry of Finance, oversaw the securities regulatory system. However, after the end of the U.S. occupation in 1952, the securities regulatory system was once again placed under the control of the Securities Business Division in the Finance Bureau of the Ministry of Finance. Then in 1964, the Securities Bureau was established within the Ministry of Finance. The Securities Bureau oversaw the securities regulatory system as a core entity for operating the license system for securities business operators over a period of about 30 years under the revised Securities and Exchange Act of 1965. During Japan's bubble economy years, the country's securities market demonstrated significant growth to become one of the major markets on a global level. On the other hand, the market came under severe criticism for lacking openness and being scandal-ridden. This, in particular the major financial and securities scandals in 1991, prompted efforts to strongly promote reforms of the securities regulatory system along with market reforms.

In 1992, the Ministry of Finance bolstered its market surveillance by establishing the Securities and Exchange Surveillance Commission (SESC) and transferring surveillance to this body. Further change came in June 1998 when the government set up the Financial Supervisory Agency as an external bureau (Article 3, "Committees" of the National Government Organization Act) of the Prime Minister's Office, to which the Ministry of Finance transferred the SESC. Subsequently, with the enforcement of the Act on Revision, etc. of Related Acts for the Financial System Reform in December 1998, the Financial Supervisory Agency took over the role of overseeing the securities regulatory system. Concurrently, the Financial Reconstruction Commission, which was established around the same time, was given the highest responsibility over the financial and securities regulatory system.

Chart XVII-3. Securities Administration and the Monitoring System for Securities Transactions, etc.

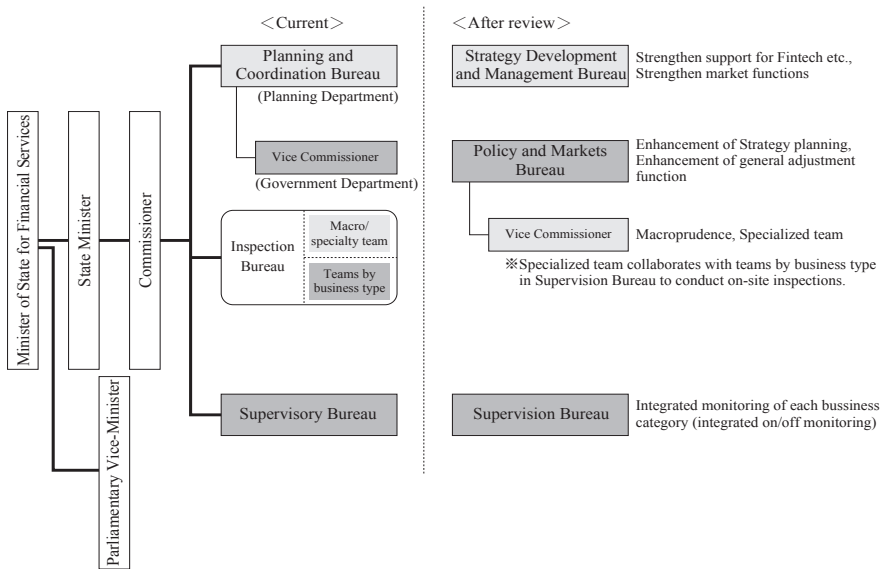


Source: Materials available on the website of the Securities and Exchange Surveillance Commission.

Then in 2000, the Financial Supervisory Agency was reorganized as the Financial Services Agency (FSA) to which the Ministry of Finance transferred the financial system planning and law drafting functions in 2001, the same year as the Financial Reconstruction Commission was transferred to the FSA and the SESC also became part of the FSA. Through this process, the major portion of securities regulation in Japan was consolidated into a system administered by the FSA and the SESC. And the policy on securities regulation shifted from preventative administration to regulatory violation surveillance. Behind this shift was the clarification of the objective of the administration to increase the welfare of people in Japan primarily through promoting sustainable growth of corporations and the economy and stable asset formation, following the winding-down of a bad debt issue among others after the collapse of the bubble economy.

New challenges for the administration have also been pointed out, including the call for further enhancement of the financial intermediary function and the design for a system to handle financial technologies. The FSA released its reorganization plan in August 2017, which included the following main objectives: (1) enhance the administration’s strategy development func-

Chart XVII-4. Reorganization of the Financial Services Agency



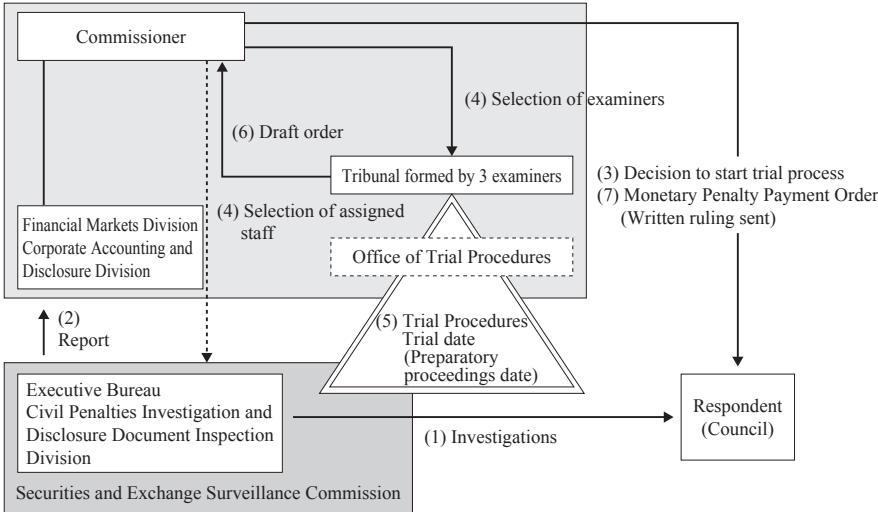
Source: The FSA.

tion, (2) upgrade the administration's professional expertise, (3) strengthen the response to FinTech, and (4) pursue a unified approach to inspection and supervision by abolishing the Inspection Bureau and integrating the role into the Supervision Bureau. The key points of functional enhancement are: (1) new establishment of Vice Commissioner for Strategy Development and Management Bureau who will also be in charge of FinTech, (2) launch of a FinTech Support Desk, and (3) establishment of a supervision & monitoring system for high-speed traders, etc.

4. Law Enforcement by the Financial Services Agency

The executive authority for the Financial Instruments and Exchange Act lies with the prime minister of Japan, the top cabinet minister, who in turn oversees the Financial Services Agency (FSA). In actual practice, the prime minister delegates this authority (with some exceptions such as the authority on approval and other treatment) to the commissioner of the FSA as stipulated in Article 194-7 "Delegation of Authority to the Commissioner of the FSA." Major types of authority delegated to the commissioner include the authority

Chart XVII-5. Flow Leading to the Payment of Administrative Surcharge



Note: Designated staff members are selected among the employees by the FSA Commissioner to assert and verify the violations, etc., in the trial proceedings. They submit preparatory documents and give evidence, etc.

Source: Materials available on the website of the Securities and Exchange Surveillance Commission.

to issue a Business Improvement Order to Financial Instrument Business Operators and Registered Financial Institutions (Article 51, Article 51-2) or an order to suspend operations or rescind their registration or approval (Article 52, Article 52-2). The FSA commissioner is also required to issue an Administrative Surcharge Payment Order if certain conditions are met. Primary examples subject to the issuance of the Administrative Surcharge Payment Order include non-submission of securities registration statements, etc. and false statement (Articles 172, 172-2, 172-3, and 172-4) and non-submission, misrepresentation and false statement of the public announcement of the start of an offering or the Tender Offer Notification (Articles 172-5 and 172-6). When any case of unfair trading practice is noted based on facts of spreading rumors, use of fraudulent means, market manipulation, or insider trading (Articles 173, 174, 174-2, 174-3, and 175), an Administrative Surcharge Payment Order is normally decided through a trial procedure and based on a draft produced by examiners (Articles 178, 185-6, and 185-7).

In addition, the following inspection authority for issuing disciplinary action by order or measures by the FSA is delegated by the commissioner to the SESC. Certain other matters and some of the matters delegated to the com-

Table XVII-2. Major Legal Basis of Inspection and Supervision by the FSA

Financial Instruments and Exchange Act		
Article 56-2		Financial Instruments Business Operators, Etc.
Article 60-11		Authorized On-Exchange Transaction Service Operators, Etc.
Art. 63 Para. 8		Specially Permitted Business Notifying Persons, Etc.
Article 66-22		Financial Instruments Intermediary Service Providers, Etc.
Article 75		Authorized Financial Instruments Firms Association, Etc.
Article 79-77		Investor Protection Fund, Etc.
Article 106-16		Major Shareholders, Etc. of Financial Instruments Exchanges and Their Holding Companies
Article 151		Financial Instruments Exchange, Etc.
Article 153-4		Self-Regulatory Organizations
Article 155		Foreign Financial Instruments Exchange, Etc.
Article 156-5-8		Major Shareholders, Etc. of Clearing Organization
Act on Investment Trusts and Investment Corporations		
Article 22		Investment Trust Management Companies and Trustee Companies, Etc.
Article 213		Investment Corporations, Etc.

mission may be delegated to the Director-General of the Finance Bureau or to the Director-General of the local finance bureau. The Director-General of the Finance Bureau collaborates with the Director of Securities and Exchange Surveillance Department of each location.

(1) The authority to require Financial Instruments Business Operators and parties executing transactions with Financial Instruments Business Operators to produce or submit for inspection reports related to such operators, and similar authority over Financial Instruments Intermediary Service Providers

(2) Similar authority over Authorized On-Exchange Transaction Service Operators (Foreign Securities Companies), etc.

(3) Similar authority over authorized-certificated organizations or parties that have received consignment of operations from such organizations

(4) The authority to require authorized associations or issuers of OTC securities to produce or submit for inspection reports

(5) The authority to require financial instruments exchanges and their subsidiaries, issuers of securities listed on respective exchanges and foreign financial instruments exchanges to produce or submit inspection reports

(6) The authority to require related parties of incidents subject to administrative surcharge to produce or submit inspection reports

The commission members carry out their investigations within the permissible scope and when considered necessary, the commission may report the matter to the prime minister or the FSA commissioner for administrative disciplinary action (Act for Establishment of the Financial Services Agency, Article 20) and other measures.

5. The Securities and Exchange Surveillance Commission

The Securities and Exchange Surveillance Commission (SESC) comprises a chairman and two other committee members appointed by the prime minister with the approval of the house of representatives and the house of councilors (Act for Establishment of the Financial Services Agency, Arts. 10 to 12). As described in the preceding section, the commission has the authority delegated by the FSA commissioner to require a wide range of people related to Financial Instruments Business Operators and registered financial institutions to produce or submit for inspection reports and materials (FIEA Art. 56-2, Art. 60-11, Art. 63, Art. 66-22, Art. 75, Art. 79-4, Art. 79-77, Art. 151, Art. 156-15, Art. 156-34, etc.). The commission also has the authority to demand the production or submission for inspection of reports and materials from the submitters of securities registration statements or Statements of Large Volume Holders and tender offers (FIEA Art. 26, Art. 27-22, Art. 27-30, etc.).

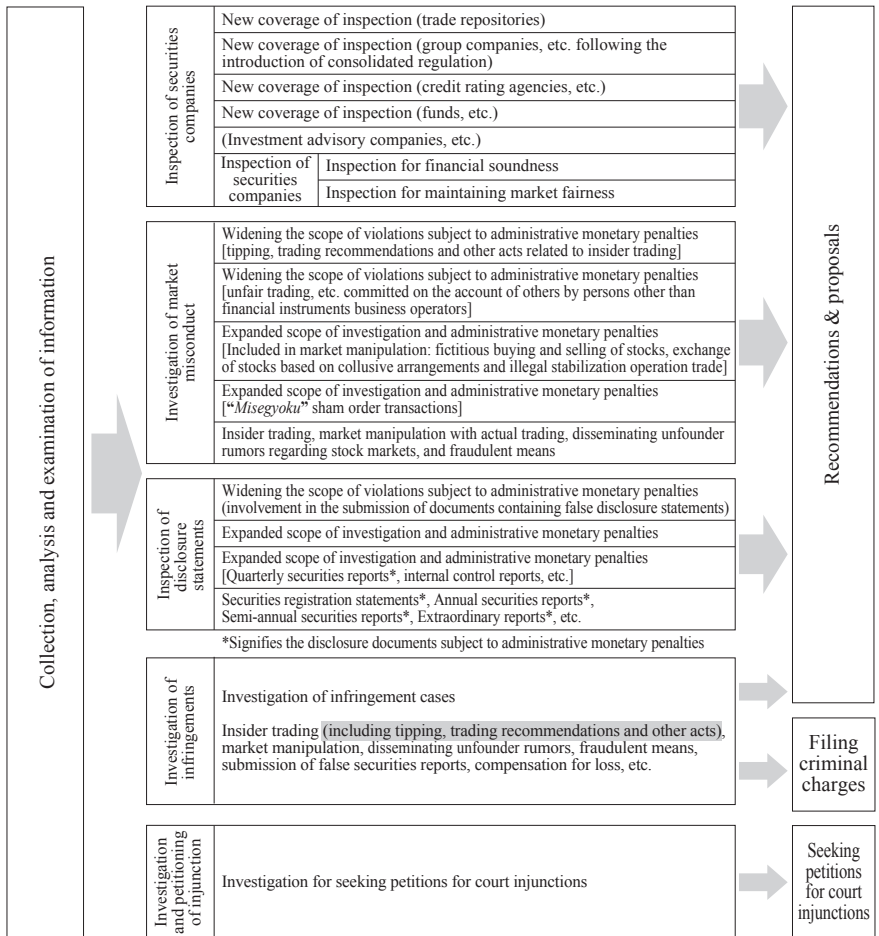
Based on this process, the commission mainly carries out the following tasks: (1) market analysis screening (daily market surveillance) involving a review of the securities trading activity of Financial Instruments Business Operators; (2) securities inspections involving wide-ranging and detailed branch inspections of Financial Instruments Business Operators and registered financial institutions; (3) disclosure inspections to ensure the appropriateness of disclosure by submitters of securities registration statements and annual securities reports; and (4) administrative surcharge investigations undertaken to determine whether certain behavior requiring an Administrative

Table XVII-3. SESC Recommendations by Business Year (as of January 31, 2018)

Business Year	92 – 10	2011	2012	2013	2014	2015	2016	2017
Total	142	15	7	3	6	8	7	4
Fake statement of Annual Securities Reports, etc.	32	4	0	0	2	3	0	0
Disseminating Unfounder Rumors · Fraudulent Means	17	4	1	1	1	2	2	0
Market manipulation or price fixing	21	1	0	1	2	1	3	2
Insider trading	65	6	2	1	1	2	2	2
Others	7	0	4	0	0	0	0	0

Source: Materials available on the website of the Securities and Exchange Surveillance Commission.

Chart XVII-6. Activities of the SESC



Source: Data disclosed by Securities and Exchange Surveillance Commission.

Surcharge Payment Order, such as unfair trading practices or disclosure violations, has occurred. Furthermore, in the case of a criminal investigation, such as the misrepresentation of material facts in a securities registration statement or annual securities report submitted or market manipulation, officials of the commission are authorized to arbitrarily investigate by questioning, examination, retention, etc. and keeping documents in custody (FIEA Article 210). In such criminal investigations, the officials also have inspection, search, and seizure authority within the scope of the warrant issued by a

judge (FIEA Article 211, etc.).

As described in the preceding section, after the commission has made its recommendations based on its securities investigations, the FSA commissioner issues orders to improve business operations, rescinds registration, or suspends operations. When the commission recommends action as a result of its administrative surcharge investigations, the commissioner issues an Administrative Surcharge Payment Order when he/she is convinced that regulations have been violated. Furthermore, when the commission is convinced that irregularities have been committed following the investigation in a criminal case, it must report the case to the Public Prosecutors Office pursuant to the provision of Article 226, Paragraph 1 of the FIEA.

One area that has been receiving attention in recent years is the issuance of Prohibition Orders and Stay Orders (Article 192, Paragraph 1) issued by the courts based on a petition made by the SESC. In the 2008 revision of the FIEA, the Securities and Exchange Surveillance Commission was given the authority to petition for these legal actions. It first used this power to deal with a business operator not registered as a financial instruments business operator in 2010 (November 2010, Daikei Co., Ltd.). It has continued to do so (most recently, F Support Co., Ltd. in April 2016 and Repair House Co., Ltd. in July 2016).

6. Self-Regulatory Organizations

A self-regulatory organization is an organization established voluntarily by intermediaries, etc. under the respective legal framework with the purpose of ensuring fair and smooth trading of securities and other transactions and of contributing to the protection of investors. It takes on the role of securing the public nature of the securities market through formulating its own rules and ensuring adherence to those rules along with the laws, regulations and other rules set out by the government.

The Financial Services Agency (FSA) acknowledges the financial services associations, certified payment service associations and designated dispute resolution organizations as self-regulatory organizations in addition to the Financial Instruments Firms Associations. Financial Instruments Firms Associations are categorized into authorized financial instruments firms associations approved by the prime minister under the FIEA (Article 67-2) and certified financial instruments firms associations designated by the prime minister under the FIEA (Article 78). The JSDA is currently the only Authorized Financial Instruments Firms Association and its members comprise Financial Instruments Business Operators and registered financial institutions. The JSDA has in place Articles of Association; fair, conventional regulations; board res-

Table XVII-4. List of Self-Regulatory Organizations Governed by the FIEA (November 2017)

	Rules, etc.	Organization
Financial instruments exchange	Licensed	Japan Exchange Regulation (see main text)
	Same as above	Nagoya Stock Exchange
	Same as above	Fukuoka Stock Exchange
	Same as above	Sapporo Securities Exchange
Financial Instruments Firms Associations	Authorized	JSDA
	Certified	The Investment Trusts Association, Japan
	Same as above	Japan Investment Advisers Association
	Same as above	Financial Futures Association of Japan
Investor Protection Organization	Same as above	Type II Financial Instruments Firms Association
	Certified	Financial Instruments Mediation Assistance Center (FINMAC)

Source: Compiled based on data available on the website of the FSA, etc.

Table XVII-5. Principal Rules of the Japan Securities Dealers Association (as of November 2017)

Self-Regulatory Rules
Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members
Rules Concerning Establishment of Confidential Corporate Information Management System by Association Members
Rules Concerning Internal Administrators, Etc. of Association Members
Rules Concerning Application for Confirmation, Examination, Confirmation, Etc. of Incidents
Rules Concerning Financial Instruments Intermediary Services Providers
Rules Concerning Elimination of Relationships with Antisocial Forces
Rules Concerning Employees of Association Members
Rules Concerning Qualification and Registration, Etc., of Sales Representatives of Association Members
Rules Concerning Distributions, Etc. of Securitized Products
Rules Concerning Maintenance of and Compliance With Ethical Code by Association Members
Uniform Practice Rules
Rules Concerning Handling of OTC Incident-Related Securities
Rules Concerning Exchanges of Bonds Drawn for Redemption by Lottery in OTC Trading
Rules Concerning Elimination of Fails in Bonds, Etc.
Dispute Handling Rules
Rules Concerning Outsourcing, etc. for Resolution of Disputes, Etc. Between Customers and Association Members
Rules Concerning Mediation of Disputes Between Association Members

olutions; and dispute handling rules; and its members are required to carry out securities transactions in compliance with these regulations and rules. The JSDA is also empowered to take disciplinary action when its members violate these association rules. The scope of its disciplinary action may include reprimand, imposition of monetary penalties, suspension or limitation of membership or expulsion, or the issuing of a formal warning (JSDA Articles of Association, Article 28, Article 29).

Certified Financial Instruments Firms Associations include The Investment Trusts Association, Japan that has investment trust management companies, trust companies, etc. that serve as trustees in investment trusts without instruction by trustor, and securities companies and registered financial institutions that purchase and sell beneficiary certificates of investment trusts as members, and The Japan Investment Advisers Association having investment advisory companies as members.

The Financial Instruments and Exchange Act (FIEA) distinguishes “stock companies that operate financial instruments exchange markets” from a “self-regulatory organization” and recognizes a “financial instruments exchange” or “its self-regulatory organization” as a self-regulatory organization relating to the exchange market. With the authorization of the prime minister, the self-regulation-related services of exchanges in Japan have been commissioned to Japan Exchange Regulation pursuant to Article 85 of the FIEA. Those services include the listing and delisting of financial instruments, inspections of compliance of members with laws and regulations, etc., and other measures specified by cabinet office order for the purpose of ensuring fair trading practices (Article 84, Paragraph 2). Japan Exchange Regulation’s organizational structure contains a listing examination department that screens listing applicants for suitability; a listing compliance department that maintains and improves the quality of the financial instruments listed on the exchange; a market surveillance and compliance department that investigates and seeks to prevent unfair trading practices; and a participant examination and inspection department that monitors compliance and implements disciplinary action. Under rule 34 of the Trading Participant Rules, violations of laws or rules and regulations by participants are punishable by revocation of trading qualifications, suspension or restriction of trading, and monetary penalties or official warnings, etc.

7. International Organization for Securities Regulation

The International Organization of Securities Commissions (IOSCO) is an international organ that sets forth global standards for the securities sector in various countries. It takes on the role of promoting, in particular, the devel-

Chart XVII-7. IOSCO Organization Chart (as of June 2016)

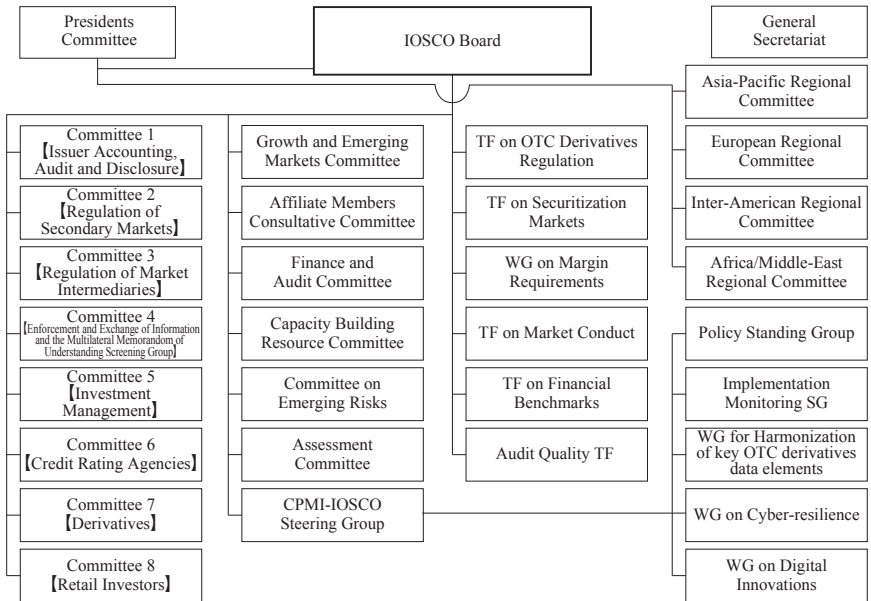


Table XVII-6. Major IOSCO Committees

Presidents Committee (Presidents Committee)	The Presidents Committee is composed of all the Presidents (Chairs) of ordinary and associate members and meets once a year during the Annual Conference. It has the right to make decisions on all matters necessary for the IOSCO to achieve its objectives.
The IOSCO Board (IOSCO Board)	The IOSCO Board is comprised of securities regulators of 34 countries, including the FSA. It is the governing and international standard-setting body for the securities industry. Under the Board are (1) policy committees that discuss policy issues and conduct policy work; among other committees is (2) the Growth and Emerging Markets Committee, comprised of regulators of emerging markets and countries, which seeks to promote the development and greater efficiency of emerging markets by establishing principles and standards and providing training, etc.
Regional Committees (Regional Committees)	There are four regional committees—Asia-Pacific Regional Committee, Inter-American Regional Committee, European Regional Committee, and African/Middle-East Regional Committee—and they discuss specific issues pertinent to their own regions. Japan belongs to the Asia-Pacific Regional Committee.

Source: Websites of IOSCO and the FSA.

opment and implementation of, and compliance with, internationally recognized securities regulations. In the process of implementing reforms to the international rules after the financial crisis, IOSCO worked in cooperation with the G20 and the Financial Stability Board (FSB) below. The IOSCO framework was established in 1974 as the Inter-American Association of Securities Commissions. In 1983, the code of the organ was revised to expand membership beyond the Americas, and the organization was renamed as IOSCO at the Paris Annual Conference in 1986. As of November 2017, there were a total of 218 member organizations, representing the regulators of over 90% of the world's securities markets. The Securities Bureau of Japan's Ministry of Finance became an ordinary member in 1988. The FSA succeeded the position thereafter and is an ordinary member at present. Other than the FSA, the Securities and Exchange Surveillance Commission also holds membership as an associate member. In addition, the Ministry of Economy, Trade and Industry and the Ministry of Agriculture, Forestry and Fisheries that share jurisdiction over commodity futures are associate members of the organization. Meanwhile, Japan Exchange Group, Inc. and the JSDA are affiliate members. IOSCO has published a wide range of principles, policies, standards, guidance, codes, recommendations, and practices regarding securities trading that have been implemented in many countries. IOSCO's documents are important also for Japan's securities regulators, which have taken steps to implement policies through defining laws and self-regulatory systems. The Financial Services Agency closely follows IOSCO trends and publishes them on its website.

The Financial Services Board (FSB) was established as an international body in April 2009, as the successor to the Financial Stability Forum (FSF) founded in 1999, with a broadened mandate to promote financial stability, the function of the FSF. Members of the FSB include financial supervising organs and central banks of 25 major countries and regions, including Japan. In addition, international organizations such as IOSCO, IMF, the World Bank, the Bank for International Settlements (BIS), and the Basel Committee on Banking Supervision are also members of the FSB. From Japan, the Bank of Japan, the FSA and the Ministry of Finance are participating members. According to the FSB Charter, the organization is responsible for the monitoring and assessment of vulnerabilities affecting the global financial system and for identifying and reviewing regulations, supervisory and related actions needed to address these vulnerabilities and their outcomes. Particularly important tasks of the FSB include the authorization of global systemically important financial institutions (G-SIFI) crucial for systems that are in place across borders and the formulation of guidelines for establishing the supervisory college. The organization also examines international standards and principles relating to the shadow banking system and other activities that

have not been subject to regulations thus far, and serves as an intermediary function to coordinate matters among related entities. The outcomes of activities of the FSB are reported and addressed as recommendations when appropriate at the G20 summit.

APPENDIX

Chronology of Events Related to Securities

(1870–2017)

Year Date	Changes implemented
Apr. 23, 1870	The Japanese government publicly offers 9% coupon bonds on the London market (the first public bond ever to be so offered).
Oct. 13, 1874	The stock trading ordinance is enacted (the nation's first securities law), but it is not enforced.
May 4, 1878	The stock exchange ordinance is promulgated.
May 15, 1878	The Tokyo Stock Exchange is established.
June 17, 1878	The Osaka Securities Exchange is established.
Mar. 4, 1893	The Securities Exchange Law is promulgated.
Aug. 1, 1894	The Sino-Japanese War breaks out.
Mar. 9, 1899	The Commercial Code is promulgated (the basic law of today's Companies Act).
Feb.10, 1904	The Russo-Japanese War breaks out.
Mar. 13, 1905	The Secured Bonds Trust Act is promulgated.
Feb. 1910	Securities brokers engage in sub-underwriting in the issuance of the No. 1 issue of public bond with 4-percent interest.
July 28. 1914	World War I breaks out.
Apr. 1, 1918	The Securities Installment Sales Act is promulgated.
Mar. 15, 1920	Stock prices crash, touching off a reactionary depression.
Apr. 20, 1922	The Securities Exchange Law is amended: development of membership-based exchange, two transaction categories - spot transactions and net-balance settlement transactions
Sept. 1, 1922	Osaka Securities Exchange starts short-term futures transactions (time bargains).

Sept. 1, 1923	Great Kanto Earthquake, September 7 Moratorium.
June 2, 1924	The Tokyo Stock Exchange starts short-term futures transactions (time bargains).
Mar. 15, 1927	Financial crisis occurs.
Mar. 30, 1927	The Banking Act is promulgated.
Apr. 22, 1927	Financial crisis continues, 3-week moratorium is implemented.
1928	The Tokyo Stock Exchange and the Osaka Securities Exchange mark their 50th anniversaries. The Tokyo Stock Exchange computes a stock price index for the first time (Fisher's ideal index, monthly average) and starts publishing it.
Oct. 24, 1929	The New York Stock Exchange crashes (Black Thursday), setting off a world-wide depression.
Jan. 11, 1930	Gold embargo is lifted, causing an outflow of massive amount of specie and an outbreak of industrial depression (Showa Depression).
Sept. 18, 1931	The Manchurian Incident breaks out.
Sept. 21, 1931	U.K. decides to terminate the gold standard, setting off a worldwide financial crisis.
Dec. 13, 1931	Reimposition of gold embargo is executed.
May 15, 1932	The Bank of Japan begins underwriting issuance of deficit-covering government bonds.
May 5, 1933	Banks and trust banks as trustees of corporate bonds initiate a clean-up movement of corporate bonds, disallowing issuance of unsecured corporate bonds.
May 27, 1933	The U.S. enacts the Securities Law.
June 6, 1934	The U.S. enacts the Securities and Exchange Law.
July 7, 1937	Marco Polo Bridge Incident occurs, setting off the Second Sino-Japanese War.
July 17, 1937	Fujimoto Bill Broker Securities forms a securities investment partnership—the first investment trust.
Mar. 29, 1938	The Securities Business Control Act is promulgated.
Mar. 31, 1938	The Securities Underwriting Business Act is promulgated.

Sept. 3, 1939	World War II breaks out.
Aug. 30, 1941	The Stock Price Control Ordinance is promulgated.
Dec. 8, 1941	The Pacific War breaks out.
Feb. 18, 1942	The Act for Registration of Corporate Bonds, etc. is promulgated.
Mar. 11, 1943	The Japan Securities and Exchange Act is promulgated. On June 30, the Japan Securities Exchange is established, and the 11 stock exchanges (as corporations) are abolished to become branch exchanges of the Japan Securities Exchange.
Oct. 19, 1943	Exchange Member Administration Guidelines are issued; Securities Business Administration Guidelines are issued (December 17)
Mar. 10, 1945	After the Great Tokyo Air Raid, the Wartime Finance Bank decides to provide unlimited support by buying at the March 9 price.
Aug. 10, 1945	Japanese stock exchanges nationwide temporarily suspend operations.
Aug. 15, 1945	Japan loses the war.
Sept. 26, 1945	The GHQ releases a memorandum (dated Sept. 25) banning the resumption of business by the securities exchange.
Dec. 1945	Investors start group trading in stocks in Tokyo and Osaka.
Apr. 17, 1946	Shinnihon-Kogyo Corporation's stock is publicly offered as the first public stock offering after the war.
Aug. 8, 1946	The Holding Company Liquidation Commission is established and begins designation of holding companies.
Jan. 18, 1947	The Act Concerning Adjustment, etc. of Disposal of Securities is promulgated.
Mar. 28, 1947	The Act Concerning Dissolution of Japan Securities Exchange is promulgated, and the securities exchange is dissolved on April 16.
Mar. 28, 1947	The Securities and Exchange Law (of 1947) is promulgated.
Apr. 14, 1947	The Antimonopoly Act is promulgated.
July 23, 1947	The Securities and Exchange Commission is established.

Apr. 13, 1948	The revised Securities and Exchange Act (of 1948) is promulgated, and it makes securities companies subject to registration.
Nov. 7, 1948	Article 65 of the Securities and Exchange Act is enforced.
Jan. 31, 1949	The GHQ announces a policy authorizing the resumption of securities trading.
Feb. 12, 1949	Securities companies hold inauguration meetings of stock exchanges in Tokyo (Feb. 12), Osaka (Feb. 15), and Nagoya (Mar. 7).
Apr. 20, 1949	Adams GHQ Officer in charge of securities instructs the three principles of securities exchange.
May 9, 1949	The Japan Securities Dealers Association is founded (as a federation of securities dealers associations).
May 16, 1949	The stock exchanges of Tokyo, Osaka, and Nagoya start floor trading.
July 4, 1949	Stock exchanges in Fukuoka, Hiroshima, Kobe, Kyoto, and Niigata start floor trading.
Apr. 1, 1950	The Sapporo Stock Exchange starts floor trading.
June 25, 1950	Disturbance outbreaks in Korea.
June 1, 1951	Margin trading is started.
June 1, 1951	The Securities Investment Trust Act is promulgated and enforced, and stock investment trusts start operating on June 15.
Jan. 4, 1952	Based on the Dow Jones stock pricing method, average stock prices (TSE average stock price) are adopted on exchanges and announced.
Apr. 28, 1952	Treaty of Peace with Japan and the U.S.-Japan Security Treaty come into effect.
Aug. 1, 1952	The Securities and Exchange Commission is abolished, and its function is transferred to the Securities Section of the Finance Bureau of the Ministry of Finance.
Sept. 10, 1952	The Securities and Exchange Council is created.
Mar. 5, 1953	Nationwide stock markets crash at the news of Russian leader Stalin is in a critical condition.

Oct. 26, 1954	The Tokyo Stock Exchange's labor union goes on strike, demanding improvements in labor conditions.
June 1955	Movements to revive term (time bargain) transactions reach a peak.
Apr. 2, 1956	The stock exchanges in Tokyo and Osaka open a bond trading market.
Oct. 7, 1958	Trading on the Tokyo Stock Exchange tops 100 million stocks for the first time.
Feb. 18, 1959	Foreign currency-denominated bonds (USD public bonds) are issued for the first time after the war.
Jan. 11, 1961	Bond investment trusts are launched.
July 18, 1961	The Dow Jones average stock price hits the peak at 1,829.74.
Oct. 2, 1961	The stock exchanges of Tokyo, Osaka, and Nagoya open Second Sections.
July 18, 1963	President Kennedy of the United States proposes the creation of an interest equalization tax, and stock prices on the Tokyo Stock Exchange crash on July 19.
Jan. 20, 1964	Japan Joint Securities is founded and continues to buy stocks from the fall season to the end of the year.
Sept. 25, 1964	Capitalization Coordinating Committee agrees to restrain capital increases after February 1965.
Jan. 12, 1965	Japan Securities Holding Association is founded, takes on stock holdings of investment trusts.
May 21, 1965	Talks about the rehabilitation of the near-bankrupt Yamaichi Securities are reported, plunging the market into a semi-crash.
May 28, 1965	The Bank of Japan decides to provide special loans to 19 management companies including Yamaichi Securities.
July 27, 1965	Economic reconstruction measures, including the policy for issuing deficit-covering government bonds, are decided.
Oct. 1, 1965	The amended Securities and Exchange Act is enforced; among other things, it requires securities companies to obtain a license from the government.
July 1, 1967	Liberalization of capital transactions (first round) is implemented.

Apr. 1, 1968	Securities companies are fully transferred to a license system.
June 4, 1968	The Tokyo Stock Exchange's market capitalization on its 1st section reaches ¥10 trillion.
Jan. 31, 1969	Nihon Gakki pursues capital increase by issuing shares on market with preferential terms for shareholders. Issuing of shares on market becomes active.
July 1, 1969	TOPIX is introduced.
Mar. 3, 1971	The Law Concerning Foreign Securities Firms is promulgated.
Jan. 24, 1973	The Dow Jones average stock price hits a peak of 5,359.74.
Feb. 13, 1973	The government shifts the exchange rate system to a floating exchange rate system.
June 2, 1973	Agreement reached with OPEC on major oil companies and raising of oil prices; the first oil crisis begins.
1975	The Ministry of Finance starts issuing a massive amount of government bonds, and the turnover of bonds on the OTC market increases sharply.
May 15, 1978	The Tokyo Stock Exchange celebrates its 100 year anniversary and enters its second century.
Mar. 30, 1979	Unsecured corporate bonds (Sears, Roebuck and Company) are issued for the first time since the end of the war.
Dec. 1, 1980	A new Foreign Exchange and Foreign Trade Act is enforced, and in- and out-bound securities investments are liberalized, in principle.
Oct. 1, 1982	Revised Commercial Code is enforced, unit share system is introduced, and the face value of newly founded company's stock is set at ¥50,000.
Apr. 9, 1983	City banks and other financial institutions start OTC sale of government bonds.
Apr. 20, 1984	The Law Concerning the Custody and Transfer of Stock Certificates is promulgated.
Oct. 19, 1985	The Tokyo Stock Exchange starts bond futures trading, the first securities futures trading since the end of the war.
Dec. 24, 1985	Merrill Lynch and five other foreign securities firms are admitted to the Tokyo Stock Exchange for the first time.

Oct. 11, 1986	NTT begins offering its shares to the general public.
Nov. 25, 1986	The Law Concerning the Regulation of Investment Advisers Relating to Securities is enforced.
June 9, 1987	The Osaka Securities Exchange starts Futures 50 trading as the first stock futures trading market.
Oct. 20, 1987	The Tokyo Stock Exchange records the largest fall (14.9%) following the crash of the New York market, Black Monday; stock price crash ripples throughout the world.
Dec. 15, 1987	The Law Concerning the Regulation of Mortgage-Backed Securities Business is enforced.
Sep. 3, 1988	The Tokyo Stock Exchange (TOPIX) and the Osaka Securities Exchange (the Nikkei 225) start stock index futures trading on full scale.
June 12, 1989	The stock exchanges in Osaka (Nikkei 225); Nagoya (Option 25, on Oct. 17); and Tokyo (TOPIX) start trading stock index options.
Dec. 29, 1989	The Dow Jones average (the Nikkei average) shoots up to an all-time high of 38,915.87.
Mar. 20, 1990	With the rapid plunge in stock prices, public offering of stocks on the market has come to a halt.
Oct. 1, 1990	Given the plunge in stock prices, the Finance Minister quickly announces measures to bolster stock prices.
June 24, 1991	Following the involvement of the big four securities companies in the loss compensation issue with corporate clients and in transactions with antisocial forces, the President of Nomura Securities and the President of Nikko Securities take responsibility and resign, which leads unfolding securities scandals over the subsequent several months.
Oct. 3, 1991	The revised Securities and Exchange Act is approved. Revisions include the prohibition of discretionary account transactions and prohibition of loss compensation dealings.
June 26, 1992	The Law Concerning Realignment of Related Laws for a Reform of the Financial System and the Securities Trading System is promulgated, and the Securities and Exchange Surveillance Commission is launched on July 20.

Aug. 18, 1992	The Nikkei stock average plunge to 14,309.41 and emergency measures are quickly announced. Comprehensive economic measures, including the injection of public funds, are revealed (August 28).
July 2, 1993	Kogin Securities and other securities companies affiliated with financial institutions were established for the first time.
Apr. 1, 1994	Brokerage commissions securities companies charge on block trading are liberalized.
Oct. 1, 1994	Amendment to the Commercial Code for deregulating treasury stock purchases is enforced.
Feb. 26, 1995	Barings Securities of U.K. goes bankrupt.
Aug. 30, 1995	Hyogo Bank goes bankrupt under the Banking Act for the first time after the war and the BOJ provides a special loan.
Sept. 8, 1995	The Bank of Japan cuts the discount rate to an all-time low of 0.5%.
Jan. 1, 1996	The regulation of the issuance of corporate bonds is abolished.
June 21, 1996	Six laws relating to housing-loan and financial matters are promulgated.
Nov. 11, 1996	Prime Minister Ryutaro Hashimoto instructs his cabinet to come up with ideas for a sweeping financial system reform to revive the Tokyo market in preparation for the 21st century (a Japanese version of the “financial Big Bang”).
Apr. 25, 1997	Nissan Life Insurance becomes the first bankrupt life insurer after the war.
June 13, 1997	The Securities and Exchange Council, the Financial System Research Committee, and the Insurance Council submit reports on measures to be taken to achieve the goals of the Japanese Big Bang.
June 20, 1997	The Act for Establishing Financial Supervisory Agency is promulgated.
Nov. 3, 1997	San'yo Securities, Hokkaido Takushoku Bank (Nov. 17), and Yamaichi Securities (Nov. 22) go virtually bankrupt.
Apr. 1, 1998	The government starts carrying out Big Bang reforms, the amended Foreign Exchange and Foreign Trade Act is enforced, and the brokerage commission on trades worth ¥50 million or more and less than ¥1 billion are liberalized.

June 22, 1998	The Financial Supervisory Agency is launched.
Sept. 1, 1998	The SPC Act is enforced.
Oct. 16, 1998	Eight laws related to financial reconstruction are promulgated.
Oct. 23, 1998	The Long-Term Credit Bank of Japan and Nippon Credit Bank, Ltd. (December 13) are placed under temporary government control.
Dec. 1, 1998	The Act on Revision, etc. of Related Acts for the Financial System Reform is enforced.
Dec. 15, 1998	The Financial Reconstruction Commission is launched.
Apr. 1, 1999	Securities companies start managing their customers' assets separately from their own.
Oct. 1, 1999	Brokerage commissions on stock transactions are liberalized.
Nov. 11, 1999	The Tokyo Stock Exchange launches Mothers market, a market for high-growth and start-up stocks.
Mar. 1, 2000	The Niigata Stock Exchange and the Hiroshima Stock Exchange are consolidated into the Tokyo Stock Exchange.
Mar. 17, 2000	The regulatory agency cancels the securities registration of Minami Securities, the first such cancellation ever in Japan.
May 8, 2000	The Osaka Securities Exchange opens the NASDAQ Japan market, later converted to the Hercules market for start-up companies on Dec. 16, 2002.
May 31, 2000	The Securities and Exchange Act as amended in 2000 is promulgated, and the portion of the Securities and Exchange Act that provides for reorganizing stock exchanges into corporations is enforced on Dec. 1.
May 31, 2000	The Act on Sales, etc. of Financial Instruments is promulgated.
July 1, 2000	The Financial Services Agency goes into operation.
Mar. 1, 2001	The Kyoto Stock Exchange is consolidated into the Osaka Securities Exchange.
Apr. 1, 2001	The special measure for the protection of the entire deposit of investors at the time of bankruptcy of a securities company is abolished.

Apr. 1, 2001	The Osaka Securities Exchange reorganizes itself into a corporation.
June 1, 2001	The system of electronically disclosing the contents of securities reports, etc. (Electronic Disclosure for Investors' NETwork "EDINET") goes into operation.
Oct. 1, 2001	The amended Commercial Code—lifting the ban on treasury stocks and instituting the system of trading units of shares—is enforced.
Nov. 30, 2001	The amended securities taxation system (which reduces the tax rate applicable to capital gains made by individuals from the sale of shares) is enforced.
Dec. 17, 2001	Nomura Holdings is listed on the NYSE.
Jan. 30, 2002	Banks' Shareholdings Purchase Corporation is established.
Apr. 1, 2002	The special measure for the protection of the entire deposit of investors expires, and the blanket government guarantee of deposits is partially lifted.
June 5, 2002	The Act on Securities Settlement System Reform Law is enacted.
Nov. 29, 2002	The Bank of Japan starts buying up cross-held shares released by banks.
Apr. 28, 2003	The Nikkei average drops to a 21-year low of ¥7,607.88.
Dec. 1, 2004	The ban on banking institutions against engaging in the securities intermediary service business is lifted.
Dec. 13, 2004	The JASDAQ Stock Exchange opens for business.
Apr. 1, 2005	The blanket government deposit guarantee is scrapped (excluding deposits used for settlement purposes).
Dec. 8, 2005	A trading error involving shares of the newly listed J-Com Co. occurs. The related transactions are settled in cash for investors on Dec. 13.
Jan. 16, 2006	The Livedoor scandal occurs, leading to the Murakami fund problem in June.
June 14, 2006	The Financial Instruments and Exchange Act is published and goes into effect Sept. 30, 2007.
Aug. 2007	The subprime loan problem looms large in U.S. markets and spreads to European markets as well.

Sept. 15, 2008	Lehman Brothers Holdings Inc. files for protection under Chapter 11 of the U.S. Bankruptcy Code, creating the Lehman Shock that spins the world into financial crisis.
Jan. 5, 2009	Japan implements a fully dematerialized registration system for stocks.
Jan. 19, 2010	Japan Airlines Co., Ltd., files with the Tokyo District Court for protection under the Corporate Reorganization Law becoming the largest business failure in Japan's post-war history.
Feb. 4, 2010	European markets plunge due to the sovereign debt crisis in Greece.
Sept. 10, 2010	The Incubator Bank of Japan, Limited declares its bankruptcy to the FSA, which announces the first ever triggering of the government's deposit insurance cap system.
Mar. 11, 2011	Great East Japan Earthquake occurs, followed by a hydrogen explosion at Tokyo Electric Power Company's Fukushima nuclear power facility on March 13.
Aug. 5, 2011	S&P lowers the long-term credit rating for U.S. government bonds from AAA to AA+.
Jan. 1, 2013	The Tokyo Stock Exchange Group, Inc. and Osaka Securities Exchange Co., Ltd., merged their operations, giving birth to the Japan Exchange Group, Inc. (JPX)
April 4, 2013	The Bank of Japan introduced a quantitative and qualitative monetary easing program aimed at achieving 2% inflation in the Japanese economy within two years.
Jan. 1, 2014	NISA, a tax saving scheme for small-amount investments, is launched.
Jan. 6, 2014	Nikkei, JPX and TSE begin calculation and distribution of JPX-Nikkei Index 400.
Mar. 5, 2015	FSA and TSE decide on the Corporate Governance Code.
Nov. 27, 2015	MOF records negative yield for the first time in the 2-year JGB auction.
Jan. 29, 2016	BOJ decides on additional monetary easing policy of applying negative interest rates in part on excess reserves at its Monetary Policy Meeting.

Feb. 23, 2016	JSDA announces conclusion of a first trade with negative interest rates on the Japanese corporate bond secondary market.
Aug. 31, 2016	Nomura Asset Management ends the management of MMFs.
May. 29, 2017	FSA recommends individual disclosure of the results of voting rights exercise for institutional investors.

The “Chronology of Events Related to Securities” that covers more details of events from 1945 is available on the Japanese-language website of the Japan Securities Research Institute (JSRI) (<http://www.jsri.or.jp/>). Events may be searched by name.

The “Chronology of Events Related to Securities” is also contained in the following publication issued by the JSRI:

“Chronology of Events Related to Securities (Meiji, Taisho, Showa)”
(1595 to January 7, 1989)

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From 1989 up to 2011, the “Chronology of Events Related to Securities” in “*Shoken Shiryō*” is published each year for the events of the previous year.