

**Interim Note on the Concept of "Trade" in Financial Instruments Business
(Summary)**

1. Identification of Issues

Under the Financial Instruments and Exchange Act¹, certain restrictions are imposed on the acts defined in the provisions of Article 2(8) thereof (Financial Instruments Trading Acts²) conducted in the course of "trade" (Financial Instruments Business³). The meaning of the term "trade" has become an issue given that for the purpose of the provision of the article, the applicability of such restrictions depends on (a) whether the acts fall under Financial Instruments Trading Acts, and (b) whether the acts are conducted in the course of "trade."

2. Arguments about the meaning of "trade"

The following are the 3 major opinions on the meaning of "trade" in terms of Financial Instruments/Securities Business:

- I. an opinion whereby "trade" means that the acts are conducted repeatedly and continuously with an element of "publicness";
- II. an opinion whereby "trade" means that the acts are conducted repeatedly and continuously; and
- III. an opinion whereby the meaning of "trade" should be considered individually with respect to each act.

The current administrative interpretation reflects the opinion described in I. It is often explained that the term "publicness" means "'trading with many and unspecified persons' or 'trading with the general public'".

¹ Hereinafter, the Securities and Exchange Act (Act no. 25 of 1948) prior to its amendment by the Act for Partial Revision of the Securities and Exchange Act, etc. (Act no. 65 of 2006) is referred to as the "Securities and Exchange Act", and the amended Financial Instruments and Exchange Act (Act no. 25 of 1948) with the change to its title is referred to as the "Financial Instruments and Exchange Act".

² "Securities Trading Acts" under the Securities and Exchange Act.

³ "Securities Business" under the Securities and Exchange Act (however, under the Securities and Exchange Act, there was a "for-profit" requirement).

In contrast, according to the opinion described in II., "publicness" does not constitute a requirement for a "trade" for the following reasons:

- (a) transactions with a small number of specified persons, such as dealings in private placements, also constitute Financial Instruments Business;
- (b) the usual meaning of the term "trade" does not include "publicness"; the term only means "being performed repeatedly and continuously";
- (c) acts conducted repeatedly and continuously for profit should be regulated, even if such acts are entered into with a small number of specified persons, in order to protect investors and ensure fairness in the markets; and
- (d) because interests in collective investment schemes are not assumed to be widely distributed among the general public, if "publicness" is imposed as a requirement for "trade", self-offerings of interests in collective investment schemes may be excluded from Financial Instruments Business.

The opinion described in III. only raises the following points in relation to the meaning of "trade":

- (a) since the sales and purchases of securities as an intermediary, broker or agent between other parties are conducted for profit repeatedly and continuously, such acts should be deemed to constitute a "trade" even if they are not entered into with many and unspecified persons;
- (b) the underwriting of securities should be considered to constitute a "trade" even if such underwriting does not involve the solicitation of general investors; and
- (c) for the self-offering/private placement of an investment trust/collective investment scheme to be deemed to constitute "conducting a trade", a person who solicits interests in a partnership must have the intention of soliciting interests in the partnership a number of times or of soliciting interests in other partnerships.

While "selling and purchasing securities" constitutes Financial Instruments Trading Acts, all of the foregoing opinions conclude that principal transactions in securities held for investment purposes (conducted only for the operator's own portfolio) should not be regulated as a Financial Instruments Business even if such transactions are conducted repeatedly and continuously. However, each opinion provides a different explanation.

3. Certain considerations

(1) General Discussion

- The opinion described in 2.III. does not clarify how to interpret the meaning of a "trade" as set forth in the provisions of Article 2(8) of the Financial Instruments

and Exchange Act. In addition, given that the requirements for a "trade" are defined and commonly applied under these provisions, to the extent possible, finding a common meaning to these provisions seems to be the consistent means of interpretation according to the text structure (though it may be necessary to explore the meaning of a "trade" in each provision separately).

- According to the opinion described in 2.II., the acts set forth in the provisions of Article 2(8) would always be considered to constitute a Financial Instruments Business if such acts were conducted repeatedly and continuously and would be subject to regulation even in unnecessary cases, unless certain exemptions were allowed under a government ordinance; therefore, this opinion does not seem to be appropriate.
- In legal terms, "conducted as a trade" is explained as follows: "this refers to the fact that a person's acts which are conducted repeatedly and continuously can be deemed to constitute performance of business operations based on social norms." This not only means "conducted repeatedly and continuously." In fact, if we randomly look at explanations of regulations under the Banking Act, the Financial Instruments Sales Act, the Money Lending Business Act, the Pharmaceutical Affairs Act, the Waste Disposal and Public Cleansing Act and the Animal Welfare and Management Act, certain other requirements apply in addition to the "repetitive and continuous nature" of such businesses: (a) systematization/collectivity; (b) the fact that the acts are entered into with many and unspecified persons; and (c) the fact that the acts can be considered to constitute performance of business operations based on social norms.
- As just explained, a "trade" should be understood as a concept which can add a requirement to limit the scope of its application in light of the purpose of the regulation and the social norms, in addition to its "repetitive and continuous nature". "Publicness" can also be understood as a requirement to limit the scope of its application in light of the purpose of the regulation and the social norms.
- The opinion described in 2.I. also explains the meaning of "publicness" as follows: "acts shall be deemed to constitute a 'trade' if the actor has a system for entering into transactions with the general public, even if the actual number of transactions is small" by focusing on the existence of a system whereby members of the general public can be parties to such transactions. In addition, the Financial Services Agency is of the opinion that "publicness" not only covers cases where acts involving "publicness" are actually conducted, but also cases where "publicness" is assumed. According to these discussions, it seems more appropriate to interpret "publicness" as meaning that the acts in question per se are "conducted by a person

responding to the requests of many and unspecified persons"^{4,5} rather than that the acts refer to "entering into transactions with many and unspecified persons' or 'with the general public'."

(2) Detailed Discussion

Questions have been raised about whether the following acts should be considered to constitute a Financial Instruments Business both in academic discussions and in practice:

- A. When a bank holding company issues new shares, if officers or employees of the bank subsidiary solicit investors to purchase such shares repeatedly and continuously, do such acts meet the definition of Financial Instruments Business as "a private placement or offering transaction"?
- B. While over-the-counter derivative and similar transactions other than those related to securities entered into with professional customers are excluded from Financial Instruments Trading Acts under the government ordinance, because such transactions are entered into between parties with risk management abilities and thus do not warrant investor protection, there is no exemption provided for over-the-counter derivative transactions related to securities, even when such transactions are entered into with professional customers. Can such transactions be interpreted to be outside the scope of regulations imposed on Financial Instruments Business?
- C. Over-the-counter currency future and option transactions entered into by an entity engaging in the sale and purchase of goods with a counterparty to such sale and purchase contracts in order to hedge the counterparty's currency risk are excluded from Financial Instruments Trading Acts under the government ordinance. This is because such transactions are not in substance independent financial transactions undertaken for investment purposes. Can derivative transactions be generally exempted from Financial Instruments Business regulation, by interpretation using the same reasoning, if such derivative transactions are incidental to other transactions that are not in substance independent financial transactions undertaken for investment purposes?

⁴ Whether or not the person responds to the requests of many and unspecified persons would be determined by the personnel and physical structures and subjective intent of that person.

⁵ The expression "in response to the requests of many and unspecified persons" refers to cases where even if the individual acts are entered into with a small number of specified persons, or if the parties to the acts are actually a small number of specified persons, the person responds to the requests of others (i.e., many and unspecified persons) who want to be parties to a transaction.

- D. (a) Over-the-counter currency future and option transactions entered into between a subsidiary and its parent company, and (b) intermediary, broker, and agent acts for over-the-counter currency future and option transactions carried out by a parent company for its subsidiary are exempted from Financial Instruments Trading Acts under the government ordinance if the parent company is required to submit securities reports and the transactions are conducted to hedge the subsidiary's currency risk because such transactions are conducted primarily for the purpose of integrated risk management within the corporate group and do not need to be regulated as Financial Instruments Business. However, according to the opinion described in 2.I., it should not be necessary to adopt a regulatory exemption because such transactions are undertaken within a corporate group and lack "publicness." Therefore, the definition of Financial Instruments Business does not apply even if the actor in the transaction is a company other than one required to submit securities reports.

The relationship between the above questions and the meaning of "trade" can be considered as follows:

- For A. above, according to the opinion described in (1) above, if the bank subsidiary conducted a private placement or offering for the bank holding company alone and not for any other issuer, such acts would not be considered to constitute Financial Instruments Business because the description: "such transactions are conducted by a person in response to the requests of many and unspecified persons" does not apply and the "publicness" requirement is not met.
- For B. and C. above, while it is more desirable to establish individual requirements and exemptions under the government ordinance, if no such legal action is taken and imposing regulation appears to be clearly against social norms, defining the scope of its application appropriately by flexibly interpreting the meaning of "trade" should be considered.
- For D. above, it is possible to interpret that acts not involving external parties, such as acts between a parent and its subsidiary or within a certain group, do not constitute "trade."

Note: The full text of this paper is available in Japanese only.