

THE NEW BANKING LAW OF JAPAN: SECURITIES BUSINESS BY BANKS

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I. INTRODUCTION

On May 25, 1981, the Japanese Diet enacted a new banking law¹ which will supercede the banking law enacted in 1927.² The new law attempts to deal with the many economic and financial changes that have occurred in Japan, especially in recent years. Most notably, the recent and anticipated issue of huge amounts of government bonds and the half-forced sale of such government bonds to banks³ made apparent the need for express provisions concerning the conduct of securities business by banks. Widespread criticism of banks for their indirect participation in the land speculation which occurred after the 1973 oil crisis led to expansion of bank activity disclosure requirements. This article will describe the major modifications made by the New Banking Law and will discuss in detail the provisions that govern banks' dealings in government securities.

A. Historical Background of the New Banking Law

Revision of the Old Banking Law began in May 1975, when the Minister of Finance asked the Financial System Research Committee ("Committee"),⁴ an advisory committee to the Minis-

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1. *Ginkōhō* (Banking Law) (Law No. 59 of 1981; hereinafter, "New Banking Law").

2. *Ginkōhō* (Banking Law) (Law No. 21 of 1927; hereinafter, "Old Banking Law", although it is expected to be effective until March 31, 1982).

3. The amounts of bonds to be underwritten by each of the underwriting financial institutions are determined by the government according to the amounts of funds available for the lending operations of those financial institutions.

4. The Committee consists of not more than twenty ordinary members and several temporary members. Ordinary members are appointed by the Minister of Finance and are selected for their extensive knowledge and experience in finance and industry, or in other fields. Temporary members are appointed by the Minister of Finance and must be persons with specialized knowledge and experience regarding a

ter of Finance, to prepare a report recommending amendments to the Old Banking Law and its related laws and regulations. On June 20, 1979, after four years of discussion, the Committee submitted its report to the Minister of Finance. The report was entitled "What Ordinary Banks Should Be and the Improvement of the Banking System" ("Committee Report").⁵ A week later, the Securities Exchange Council ("Council")⁶ submitted to the Minister of Finance a report entitled "Current Problems of Government and Corporate Bond Market" ("Council Report").⁷

The Ministry of Finance ("MOF") then used the reports to formulate the so-called "three basic principles" (*san gensoku*) that were to be reflected in the New Banking Law: (1) banks should be expressly permitted to engage in securities business involving government bonds; (2) banks should be required to have a validation⁸ under the Securities and Exchange Law⁹ before conducting securities business; and (3) the circumstances under which such validations will be granted should be determined administratively,

specific matter. As of June 20, 1979, the ordinary members consisted of four professors, two persons from financial institutions, three persons from government-related financial institutions, one person from the securities industry and ten others.

5. Financial System Research Committee, *Futsū-Ginkō no Arikata to Ginkō-Seido no kaisei ni Tsuite* (What Ordinary Banks Should Be and the Improvement of the Banking System) (1979), *partly reprinted in* KINYŪ ZAISEI JIJŌ, June 25, 1979, at 44.

6. The Council consists of thirteen members who are appointed by the Minister of Finance from among persons of learning and experience. As of June 27, 1979, the members included two persons from banks, one from the securities industry, one from the Tokyo Stock Exchange and nine others.

7. Securities Exchange Council, *Kōshasai-Shijō Tōmen no Shomondai ni Tsuite* (Current Problems in Government and Corporate Bond Markets) (1979).

8. The term "validation" means an act by the administrative authorities to supplement and perfect the legal effect of an act by a third party. The act is not one that is generally prohibited; therefore, its performance would not subject the third party to a penalty. However, the failure to obtain a "validation" might make the act invalid. For example, although bank mergers are not generally prohibited, article 30(1) of the New Banking Law does require a validation by the Minister of Finance before such a merger can be effective.

In contrast, the term "license" refers to an act by the administrative authorities which removes a general legal prohibition against certain activity, thereby permitting the licensed party to engage in such activity. To act without the required license might subject the acting party to penalty; however, the act would not necessarily be invalid. For example, article 4(1) of the New Banking Law provides that no person may engage in the banking business without obtaining a license from the Minister of Finance. One who does engage in banking without a license will be subject to a penalty (article 61 of the New Banking Law), but loans made and deposits received by such person would not necessarily be invalid.

Because securities business by banks is neither generally prohibited nor subject to licensing requirements under articles 2(8) and 28(1) of the Securities and Exchange Law, note 9 *infra*, it is most accurate to say that a bank must obtain a "validation" before engaging in the securities business.

9. *Shōken Torihiki Hō* (Securities and Exchange Law) (Law No. 25 of 1948; hereinafter, "Securities and Exchange Law," or "SEL").

rather than in the new act. In December 1980, and in January 1981, the MOF transmitted to the banking industry these "three basic principles" and the broad outlines of a proposed amendment to the Old Banking Law.¹⁰ The banking industry strongly objected to the MOF's proposals and submitted opinions to the MOF.¹¹

Despite this opposition, the Banking Department of the MOF drafted the new banking law bill¹² along the lines of the "three basic principles". After bitter negotiations among the MOF, the Liberal Democratic Party, the banking industry and the securities industry, the Cabinet finally decided on a draft of the new banking law bill¹³ on April 21, 1981. After discussions in the Finance Committees of the Diet, both the Lower and Upper Houses eventually adopted the bill with no modifications. The New Banking Law was published in the official gazette¹⁴ on June 1, 1981.

B. The Japanese Banking System

Before discussing the New Banking Law in detail, we should first take a brief look at the banking system in Japan. Unlike the United States, where there is a federal/state dual banking system, Japan has only one chartering authority, the MOF, which is also the only regulatory agency for banks in Japan. It should be noted that the Ministry of Finance also acts as the licensing and supervisory authority for securities companies. It may amaze readers to know that since 1954 no license has been granted to a new bank in Japan. While in the United States there are many banks (approximately 14,500), mostly with a small number of offices, there are only 86 banks in Japan. Twelve of them, which are called city

10. MOF, *Ginkōhō-an ni Tsuite no Ōkura-shō Ginkō-kyoku no Kangaekata* (Outline of the Proposed Banking Law Bill by the Banking Department of MOF); and *Ginkō no Shōken-gyōmu no Ichi-Zuke ni Tsuite* (Positioning of Securities Business by Banks), both reprinted in KINYŪ ZAISEI JIJŌ, Jan. 19, 1981, at 14.

11. See National Federation of Association of Banks, *Ginkōhō Kaisei ni Kansuru Iken* (Opinion on the Proposed Amendment to the Old Banking Law); and National Federation of Association of Banks, *Ginkōhō Kaisei ni okeru Yūka-shōken no Hikiuke-Boshū no Toriatsukai Baibai sonota no Shōken-gyōmu ni Kansuru Iken ni Tsuite* (Opinion on Underwriting, Handling of Placement, and Sale and Purchase of Securities, and Other Securities Business in the Proposed Business in the Proposed Amendment to the Old Banking Law) (1981), both reprinted in KINYŪ ZAISEI JIJŌ, Jan. 19, 1981, at 18 (hereinafter, "Bank Association Opinions"). See also National Federation of Association of Banks, *Ginkōhō Kaisei ni Kansuru Iken (Sono-ni)* (Opinion on the Proposed Amendment to the Old Banking Law—No. 2) (1981), reprinted in KINYŪ HŌMU JIJŌ, Feb. 25, 1981, at 25.

12. Banking Department of the MOF, *Ginkōhōan Soko* (Draft of the Banking Law Bill) (Feb. 27, 1981), reprinted in KINYŪ ZAISEI JIJŌ, Mar. 9, 1981, at 16 (hereinafter, "Draft").

13. *Ginkōhōan* (The Banking Law Bill), reprinted in KINYŪ ZAISEI JIJŌ, April 27, 1981, at 17 (hereinafter, "Bill").

14. KANPŌ (June 1, 1981).

banks, each have approximately 200 offices, as shown in the following chart, correct as of March 31, 1981:¹⁵

	<u>Number</u>	<u>Branches</u>
Ordinary banks:		
City banks	12	2,697
Local banks	63	5,411
Special banks:		
Long-term credit banks	3	66
Trust banks	7	333
Foreign exchange bank	<u>1</u>	<u>79</u>
TOTAL	86	8,586

1. *Types of Banks.* In general, city banks have branches nationwide whereas local banks have branches only locally. This distinction is for convenience only, and there is no difference between city banks and local banks in terms of the application of provisions of the New Banking Law. City banks and local banks collectively are called "ordinary banks".

"Special banks" are divided into three categories: long-term credit banks, trust banks and a foreign exchange bank. Long-term credit banks are those banks licensed under the Long-Term Credit Bank Law¹⁶ to engage in long-term financing. Under the Long-Term Credit Bank Law, long-term credit banks are allowed to issue bonds and are generally restricted in the collection of deposits. They may receive deposits only from the national government, local public bodies or customers with whom transactional relationships exist.¹⁷ Trust banks are ordinary banks which are specialized in engaging in the trust business under the Trust Business Law.¹⁸ Their principal business activities are the obtaining of funds through such means as investment trusts and loan trusts and the lending of such funds to industries on a long-term basis.

A foreign exchange bank is a bank licensed under the Foreign Exchange Bank Law¹⁹ to specialize in foreign exchange transactions and trade financing. Foreign exchange banks are restricted in their ability to establish branches, because article 9 of the Foreign Exchange Bank Law specifically provides that a foreign exchange bank may establish a branch or other office only at a place where it is important to conduct foreign exchange transac-

15. TÖYÖ KEIZAI, Aug. 13, 1981, at 175.

16. *Chōki Shinyō Ginkō Hō* (Long Term Credit Bank Law), art. 2 (Law No. 187 of 1952; hereinafter, "Long Term Credit Bank Law").

17. *Id.*, art. 6(1)(iii).

18. *Shintaku-gyō Hō* (Trust Business Law) (Law No. 65 of 1922; hereinafter, "Trust Business Law").

19. *Gaikoku Kawase Ginkō Hō* (Foreign Exchange Bank Law), art. 2 (Law No. 67 of 1954; hereinafter, "Foreign Exchange Bank Law").

tions and trade financing. Foreign exchange banks are also allowed to issue bonds.²⁰ At present, the Bank of Tokyo is the only foreign exchange bank. Foreign exchange banks should be distinguished from *authorized foreign exchange banks*, a term comprising both foreign exchange banks and those banks which have obtained validations from the Minister of Finance to engage in the foreign exchange business.²¹

At this point, two significant characteristics of the financial system of Japan ought to be considered—the separation of long-term finance from short-term finance and the separation of banking business from securities business.

a. *Separation of Long-term and Short-term Finance.* In Japan, since before World War II, the policy that short-term finance should be supplied from short-term funds and long-term finance should be supplied from long-term funds has been adopted based on what was considered to be sound banking practice. This has resulted in a separation of the policy function of ordinary banks from that of long-term credit banks and trust banks. Because ordinary banks obtain funds necessary for their lending operations mainly from short-term deposits, they have been directed to concentrate on short-term finance.

After World War II, pursuant to the policy of the General Headquarters of the United States occupation authorities (“General Headquarters”), long-term funds had to be procured in the capital market. Thus, special banks which had issued long-term bonds in the pre-war period were required to convert into ordinary banks. However, because the Japanese securities market at that time was not well enough developed to provide sufficient long-term funds to meet the demands of Japanese companies, demands for long-term funds were directed to ordinary banks. In 1950, in order to enable banks to furnish long-term funds, every bank was allowed to issue bonds under the Law Concerning Issue of Bonds by Banks, *et al.*²² This measure was criticized, though, on the grounds that it would result in confusion between the long-term and short-term finance markets. The law was repealed with the enactment of the Long-Term Credit Bank Law²³ in 1952. Under the latter law, long-term credit banks were allowed to issue

20. *Id.*, art. 9-2.

21. *Gaikoku Kawase oyobi Gaikoku Bōeki Kanri Hō* (Foreign Exchange and Foreign Trade Control Law) art. 11 (Law No. 228 of 1960; hereinafter, “Foreign Exchange Law”).

22. *Ginkō tō no Saiken Hakkō tō ni Kansuru Hōritsu* (Law Concerning Issue of Bonds by Banks, *et al.*) (Law No. 40 of 1950).

23. Long Term Credit Bank Law, note 16 *supra*.

bonds and were expected to meet the demands of industry for long-term funds.

The long-term finance function of the trust banks has a different origin. In 1955, there existed six trust banks which originally were trust companies under the Trust Business Law²⁴ and eleven ordinary banks which engaged in trust business. Since the trust business developed mainly around loan trusts created in 1952 to furnish long-term funds to basic industries, in 1955 the MOF adopted a policy that trust banks were to provide long-term financing and ordinary banks were to provide short-term financing. As a result, the six trust banks which originally were trust companies became, at their election, either trust banks which specialize in trust business or ordinary banks not engaging in trust activities; most of the eleven ordinary banks which engaged in trust business either closed down or spun off their trust business. At present, there are seven trust banks which specialize in the trust business and one ordinary bank which still engages in trust business.

b. *Separation of Banking Business and Securities Business.* Before World War II, banks and trust companies acted as the principal underwriters for bonds issued by corporations, while securities companies constituted a subordinate underwriting group. When the Securities and Exchange Law²⁵ was enacted in 1948, article 65, which prohibits banks and other financial institutions from engaging in the securities business, was inserted at the request of General Headquarters. However, unlike the Glass-Steagall Act²⁶ of the United States, the Securities and Exchange Law permits banks to acquire stocks and bonds for investment purposes.²⁷ Thus, the Securities and Exchange Law is not sufficient to protect bank depositors from investment risks taken by banks. According to some academic authorities, the primary purpose of article 65 is to encourage the development of securities companies by prohibiting banks from underwriting securities; thus, the protection of depositors is merely a secondary purpose.²⁸

Historically, the securities market in Japan has lagged behind the financial market because of the government's policy of main-

24. Trust Business Law, note 18 *supra*.

25. SEL, note 9 *supra*.

26. Banking Act of 1933, § 16, 12 U.S.C. § 24(7) (1976).

27. The Antimonopoly Law prohibits any bank from acquiring in excess of five percent of the total outstanding shares in a domestic corporation. *Shiteki Dokusen no Kinshi oyobi Kōsei Torihiki no Kakuho ni Kansuru Hōritsu* (Law Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade) art. 11 (Law No. 54 of 1947, hereinafter, "Antimonopoly Law").

28. T. SUZUKI & I. KAWAMOTO, SHŌKEN TORIHIKI HŌ (Securities and Exchange Law) 68 (1968). (hereinafter, "SUZUKI & KAWAMOTO").

taining low interest rates in order to enhance trade. Thus, bank loans have played a major role in furnishing industries with necessary funds for plant and equipment investments. During the Meiji Era, the government and a small number of *Zaibatsu*²⁹ were the primary sources of industrial funds. The lack of adequate capital accumulation in the economy meant that the securities market became a speculative market rather than an investment market. This problem was compounded by the fact that many companies in the *Zaibatsu* groups either were not stock corporations or were closed corporations. After World War I, although many bonds were issued in order to satisfy demands for industrial funds, these bonds were mainly purchased by banks rather than individuals. The superiority of the financial market and banks as compared to the securities market and securities companies, and the need for the protection and promotion of the securities market and securities companies, have been important factors in various conflicts involving banks and securities companies in the past, including the debate over the "three basic principles" that were to guide the formulation of the New Banking Law.

There is another set of legal provisions which stands behind the separation of the banking and securities industries. The Law Concerning Implementation of Amendments to the Commercial Code ("Implementation Law")³⁰ provides that no person other than a bank or trust company may provide certain administrative services in connection with the placement of bonds or may act as trustee for the holders of such bonds. Moreover, article 45 of the Securities and Exchange Law prohibits a securities company from providing such services or acting as trustee for bondholders.

As defined in the Commercial Code,³¹ the services at issue here include the preparation of subscription forms for bonds, allotment of bonds to subscribers, the acceptance of payment for bonds and their delivery in the servicing company's name for the benefit of an issuing company. After the issuance of bonds, a company which undertakes to provide these services has the power to take any actions necessary for the protection of the rights of bondholders. The foregoing provisions of the Implementation Law and the Securities and Exchange Law are designed to leave

29. *Zaibatsu* were groups of financial, industrial and trading companies which were controlled by holding companies owned by families. Before World War II, the Japanese economy was dominated by a small number of *Zaibatsu*. After World War II, the *Zaibatsu* were dissolved at the request of General Headquarters. Article 9, paragraph 1, of the Antimonopoly Law, note 27 *supra*, now prohibits the establishment of holding companies.

30. *Shōhō chū Kaisei Hōritsu Shikō Hō* (Law Concerning Implementation of Amendments to the Commercial Code) art. 56 (Law No. 73 of 1938).

31. COMMERCIAL CODE, arts. 301, 304, 309, 314 (Law No. 48 of 1899).

to securities companies the tasks of selling and offering bonds while leaving to banks and trust companies the job of protecting the bondholders.

It has been pointed out,³² however, that there are inconsistencies between these provisions and the Secured Bond Trust Law.³³ Under article 30 of the Secured Bond Trust Law, a securities company which underwrites an entire issue of bonds acquires all the powers which a company engaged to provide the foregoing services has under the Commercial Code. This result contradicts article 45 of the Securities and Exchange Law, which prohibits securities companies from providing such services. Thus, in practice, securities companies do not underwrite an entire issue of bonds but only undertake to handle the placement³⁴ of an entire issue, and if all the bonds are not purchased, to underwrite the remaining bonds. On the other hand, a bank which undertakes to provide these services would have the right to advertise the offering of bonds in its name, were it not for the fact that this would violate article 65 of the Securities and Exchange Law, which prohibits banks from engaging in the securities business, including handling the placement of bonds. In practice, such advertisement is done in the name of the issuing company.

C. Major Provisions of the New Banking Law

The major changes contained in the New Banking Law are as follows:

(1) With the validation of the Minister of Finance, banks now may engage in securities business with respect to national government bonds, local government bonds and bonds guaranteed by the national government.³⁵ The Old Banking Law has no express provisions relating to securities business by banks. This subject will be discussed in detail in Part II of this article.

(2) A bank may not extend credit to one person in excess of a certain percentage of its capital and surplus.³⁶ Although the Old

32. SUZUKI & KAWAMOTO, *supra* note 28, at 78.

33. *Tanpo-tsuki Shasai Shintaku Hō* (Secured Bond Trust Law) (Law No. 52 of 1905).

34. Japanese securities law distinguishes placement from secondary sale. Placement (*boshū*) means to offer newly issued securities for sale to the general public on fixed terms. Placement can be done only by an issuer of such securities. Securities companies engaged by the issuer to sell securities to the public are said to be "handling the placement of securities".

Secondary sale (*uridashi*) means to offer outstanding securities to the general public on fixed terms. In this article, the terms "placement", "handling the placement" and "secondary sale" have the meanings set forth in this footnote.

35. New Banking Law, *supra* note 1, arts. 10(2)(iv) and 11; art. 5 of the Supplementary Provisions, which are part of the statute.

36. New Banking Law, *supra* note 1, art. 13. The term "capital and surplus" will

Banking Law does not provide for lending limits, lending limits have been implemented through a directive issued in December 1974, by the Director of the Banking Department of the MOF.³⁷ Under this directive, the percentages applicable to an ordinary bank, a long-term credit bank, a trust bank and a foreign exchange bank are 20%, 30%, 30% and 40% of capital. The New Banking Law provides that a Cabinet Order shall determine such respective percentages.³⁸ It is expected that such a Cabinet Order will be promulgated in February or March, 1982, and that the applicable percentages will be the same as in the 1974 directive.³⁹ However, the effective limits under the New Banking Law will be more than the prescribed percentages under the directive, because it also is expected that in calculating the amounts lent, discounts of commercial drafts and loans secured by deposits, government bonds or export insurance policies will be excluded from the total.⁴⁰

(3) Banks must publish balance sheets and profit and loss statements for each business period.⁴¹ At present, banks are required to publish balance sheets for each business period under article 11 of the Old Banking Law and to file securities reports for each business period under article 24 of the Securities and Exchange Law. In addition to requiring publication of the balance sheets and profit and loss statements,⁴² the Draft would have required publication of a statement concerning the disposition of profits and losses. Also, banks would have had to disclose information about their holdings and their loans which would have revealed the banks' asset structures.⁴³ However, these disclosure requirements were deleted during subsequent negotiations.

(4) The business period of banks must be a one year period

be defined in a future Cabinet Order. The current directive on lending limits uses the term "its own capital" instead of "capital and surplus". "Its own capital" means the aggregate amount of the capital (not including that distributed as dividends) and allowances (including those amounts reserved to make good for losses) which are set forth in the forms prescribed in the Enforcement Rules of the Old Banking Law, note 2 *supra*.

37. Director of the Banking Department of the MOF, *Ginkō no Ōguchi Yūshi Kisei ni Tsuite* (The Lending Limits of Banks) (Kura-Gin No. 4481, Dec. 25, 1974).

38. New Banking Law, *supra* note 1, art. 13.

39. *Hearings on the Bill Before the Finance Comm. of the Lower House*, 94th Diet, 26 (May 13, 1981) (statement of Hiroshi Yonesato, Director of the Banking Dept. of the MOF).

40. *Id.*, at 11. According to Mr. Yonesato's statement, the effective rates applied to a city bank, long-term credit bank and foreign exchange bank would be 25%, 30.6% and 46.8% respectively.

41. New Banking Law, *supra* note 1, art. 20. See next paragraph to text.

42. Draft, *supra* note 12, art. 22.

43. *Id.*, art. 23.

from April 1 to March 31 of the immediately following year.⁴⁴ Article 9 of the Old Banking Law provides that the business period of banks shall be each six month period from April to September and from October to March of the immediately following year, but at present, almost all listed companies have business periods of one year. The new law brings banks into line with standard commercial practice by providing for a one year bank business period to run from April 1 through March of the next year.

(5) The government is authorized to determine bank holidays.⁴⁵ Article 18 of the Old Banking Law provides that holidays of banks shall be limited to national holidays, Sundays and general holidays observed at the place of a bank office. Thus, Saturdays cannot be made bank holidays under the Old Banking Law. In line with the custom in the United States and other Western countries, the New Banking Law has paved the way to make Saturdays bank holidays.

(6) In order to clarify the regulation of foreign banks, more detailed provisions relating to the supervision of foreign banks and their branches are included in the New Banking Law.⁴⁶ The Old Banking Law has only one provision concerning foreign banks.⁴⁷

(7) Article 1 of the Supplementary Provisions to the New Banking Law⁴⁸ provides that it shall take effect on a date within one year from the date of the publication and which is to be designated by a Cabinet Order. Such Cabinet Order has not yet been promulgated, but it is expected that the effective date of the New Banking Law will be April 1, 1982.⁴⁹ It is not clear when banks may start such securities business activities as handling the placement or secondary sale⁵⁰ of and trading in government bonds. It is said that the Minister of Finance will consult with the so-called "three member board" before deciding when to grant to banks the validations required under the New Banking Law and under the 1981 Amendment to the Securities and Exchange Law⁵¹ for banks

44. New Banking Law, *supra* note 1, art. 17.

45. *Id.*, art. 15.

46. *Id.*, arts. 47 through 52.

47. Old Banking Law, *supra* note 2, art. 32.

48. These provisions appear as an appendix in the New Banking Law, note 1 *supra*.

49. *Hearings on the Bill Before the Finance Comm. of the Lower House*, 94th Diet, 4 (May 8, 1981) (Statement of Hiroshi Yonesato, Director of the Banking Dept. of the MOF).

50. *See* note 34 *supra*.

51. *Shōken-Torihiki-hō no Ichibu o Kaisei suru Hōritsu* (1981 Amendment to the Securities and Exchange Law) (Law No. 62 of 1981; hereinafter, "1981 SEL Amendment").

to engage in such securities business.⁵²

(8) Article 47(2) of the New Banking Law provides that when a foreign bank has obtained a license from the Minister of Finance to engage in the banking business in Japan through its branch or agency in Japan, such foreign bank shall be subject to the provisions of the New Banking Law, with such branch or agency being deemed a bank within the meaning of the New Banking Law and with a representative of such branch or agency being deemed a director of such branch or agency. However, the proviso to this paragraph explicitly excludes the application to a foreign bank of certain provisions of the New Banking Law.⁵³ Details regarding the application to foreign banks of the provisions in the New Banking Law will be provided for in a new Cabinet Order.⁵⁴ One important provision in this connection is article 6, paragraph 2, of the Supplementary Provisions to the New Banking Law.⁵⁵ It provides that article 13 of the New Banking Law, which limits the credit that may be extended to one person, shall not be applied to a foreign bank branch for five years from the effective date of the New Banking Law, which is expected to be April 1, 1982.⁵⁶

II. THE CONDUCT OF SECURITIES BUSINESS BY BANKS

A. "Security" Defined

Unlike United States securities regulation, under which the definition of "security" is broad and all-inclusive, the definition of "security" under the Securities and Exchange Law includes only those items listed in article 2(1) of that law.⁵⁷ Although the scope

52. *Hearings on the Bill Before the Finance Comm. of the Lower House*, 94th Diet, 4 (May 8, 1981) (Statement of Hiroshi Yoshimoto, Director of the Securities Dept. of the MOF).

The members of the board are: Teiichirō Morinaga, the former president of the Bank of Japan; Nao Sasaki, chairman of the Committee; and Tsuchi Kōno, chairman of the Council. *See Nihon Keizai Shimbun*, October 3, 1981.

The board came into existence because of a compromise between the banking industry and the MOF. Before the new banking law bill was submitted to the Diet, the industry asked the MOF to clarify when banks would be given validations to conduct securities business. *See Nihon Keizai Shimbun*, evening ed., April 14, 1981. The MOF adhered to its three basic principles, and left the time undetermined in the bill. However, MOF did say it would consult the board on the issue.

53. Some examples of such provisions are those which relate to minimum capital requirements, the mandatory use of the word *Ginkō* (which means "bank") in the trade name of a Japanese bank, the acquisition of stocks of foreign subsidiaries and the validation of statutory mergers.

54. New Banking Law, *supra* note 1, art. 47(3).

55. New Banking Law, note 1 *supra*.

56. *See* note 49, *supra* and accompanying text.

57. Under the Securities and Exchange Law, *supra* note 9, art. 2(1), the term

of the term can be broadened by a Cabinet Order, at present no such orders have been promulgated. Thus, neither a negotiable certificate of deposit nor commercial paper is a security under the Securities and Exchange Law. Securities companies may not engage in "securities" business with respect to negotiable certificates of deposit or commercial paper because article 43 of the Securities and Exchange Law currently provides that securities companies may not engage in any business other than the securities business and securities-related businesses.

If negotiable certificates of deposit and commercial paper were designated as securities under the Securities and Exchange Law, banks would be prohibited from engaging in securities business relating to those instruments unless article 65 of the Securities and Exchange Law were amended.⁵⁸ As a way out of this predicament and to enable securities companies to engage in "securities" business with respect to negotiable certificates of deposit and commercial paper without designating them as securities under the Securities and Exchange Law, the 1981 SEL Amendment⁵⁹ modified article 43 by inserting the phrase, "securities-business-related business", as one of the businesses permitted to securities companies in addition to securities business and securities-related business. The phrase "securities-business-related business" is intended to indicate transactions involving negotiable certificates of deposit and commercial paper.⁶⁰ It is said that⁶¹ the Minister of Finance will permit securities companies to engage in such securities-business-related business, without a waiting period, immediately after the effective date of the 1981 SEL Amendment, which is expected to be April 1, 1982.⁶²

"security" is defined as: (a) national government bonds; (b) local government bonds; (c) bonds issued by corporations pursuant to a special law; (d) secured or unsecured corporate bonds; (e) certificates representing equity contribution issued by a corporation organized under a special law; (f) share certificates (including fractional share certificates) or certificates representing rights to subscribe for new shares; (g) certificates representing beneficiary rights to a securities investment trust or loan trust; (h) bonds or certificates issued by foreign countries or foreign corporations and having the same nature as those bonds or certificates listed in any of the foregoing items; and (i) such other bonds or certificates as are prescribed by a Cabinet Order.

58. See notes 141-151 & accompanying text *infra*.

59. 1981 SEL Amendment, note 51 *supra*.

60. *Hearings on the Bill Concerning Amendment of the Securities and Exchange Law Before the Finance Comm. of the Lower House*, 94th Diet, 6 (May 8, 1981) (Statement of Hiroshi Yoshimoto, Director of the Securities Dept. of the MOF).

61. *Id.*

62. In this connection, it should be noted that negotiable certificates of deposit and commercial paper already are "securities" under the Foreign Exchange Law, note 21 *supra*, and orders thereunder. (MOF Order Concerning Foreign Exchange Control), art. 2 (MOF Order No. 44 of 1980).

B. Securities Business In Government Bonds Before the 1981 Amendments

National government bonds are classified as either long-term government bonds which have a maturity of one year or more or short-term government bonds which have a maturity of less than one year. Long-term national government bonds are underwritten by an underwriting syndicate group which consists of ordinary banks, long-term credit banks, trust banks, securities companies, insurance companies and other financial institutions. Under the Supplemental Agreement Among Underwriters,⁶³ no underwriter other than a securities company may handle the placement of government bonds.⁶⁴ Therefore, at present banks undertake to purchase, in proportion to the amounts of bonds underwritten by them, those government bonds which remain unsold in excess of the amounts of bonds underwritten by securities companies, notwithstanding efforts of securities companies to sell government bonds to institutional or individual investors.

Short-term government bonds are issued to supplement the temporary shortage of funds due to the timing difference between the collection and disbursement of revenue.⁶⁵ Almost all short-term government bonds are underwritten by the Bank of Japan, because such bonds are not subject to the Finance Law⁶⁶ prohibition on bond underwriting by the Bank of Japan. Until very recently, almost all short-term government bonds were held by the Bank of Japan and there existed no market for them. However, in May 1981, for the first time the Bank of Japan sold short-term government bonds through short-term fund companies (*tanshi kai-sha*) to securities companies, ordinary banks, trust banks and other financial institutions. This means that there will be a short-term government bond market in Japan comparable to the Treasury bill market in the United States.

1. *Under the Old Banking Law.* Article 1 of the Old Banking Law defines "banking business" as receiving deposits, lending money, discounting drafts and carrying out exchange transactions. In addition, under article 5 banks are permitted to engage in: (1) trust activities with respect to secured bonds pursuant to the Secured Bond Trust Law;⁶⁷ (2) the safe deposit business; and

63. *Ritsuki Kokko Saiken no Boshū Toriatsumakai ni Kansuru Hikiuke-dan Oboegaki* (Supplemental Agreement Among Underwriters).

64. *Id.*, art. 1. Furthermore, placement may be done only by the issuer of such securities. See note 34 & accompanying text *supra*.

65. At present, short-term government bonds are issued by the MOF, the Food Control Special Account, and the Foreign Exchange Fund Special Account.

66. *Zaiseihō* (Finance Law) (Law No. 34 of 1947; hereinafter, "Finance Law").

67. Secured Bond Trust Law, note 33 *supra*.

(3) other related business. Banks may not engage in any other businesses. The scope of the term "related business" is unclear both in Japan and in the United States. One interpretation issued by the Banking Department of the MOF stated:

The related business of banks refers to subordinate business necessary or useful to engage in the banking business set forth in article 1 of the Banking Law. Whether or not certain business falls within the category of related business should be determined taking into consideration the nature of such business and the amount of such business to be dealt with by banks. Safe deposit, collection of debts, sale and purchase of gold bullion, *sale and purchase of securities*, guarantee of obligations, acting as depository for governments, local public agencies and corporations, exchange of currency, acting as agent for other banks, etc. are considered to be within the scope of the related business of banks. (emphasis added)⁶⁸

It has never been clear whether the "sale and purchase of securities" referred to in this interpretation includes trading of securities or means only such sales and purchases as are made in connection with the management of banks' assets. Significantly, however, when this interpretation was issued, major banks already were engaged in the underwriting business. Major banks had been acting as underwriters of bonds issued by corporations since around 1900; the Old Banking Law was enacted in 1927; and the foregoing interpretation was issued in 1928. In the securities issue market before World War II, major banks usually acted as primary underwriters, and securities companies were only subordinate underwriters which entered into underwriting agreements with the primary underwriters. As noted earlier, after World War II, article 65 of the Securities and Exchange Law prohibited certain financial institutions from engaging in the "securities business", with a few exceptions. But even after the enactment of the Securities and Exchange Law, most scholars and commentators maintained that, so far as the banking law is concerned, "securities business" is included in the related business of banks.⁶⁹ Accordingly, it is considered legally possible for banks to sell government bonds directly to their customers at each office, although this is not done in practice. Advocates of this theory support their arguments by pointing out that government bonds are different from other bonds in that they are nearly risk-free.

68. Director of the Banking Department of the MOF, *Related Business of Banks* (May 2, 1928, Kura-Gin No. 2454), reprinted in H. SATAKE & O. HASHIGUCHI, *GINKŌ GYŌSEI TO GINKŌHŌ* (Bank Administration and Banking Law) 153 (1967) (hereinafter, "SATAKE and HASHIGUCHI").

69. See SUZUKI & KAWAMOTO, *supra* note 28, at 76; SATAKE and HASHIGUCHI, *supra* note 68, at 154.

During the debates in the Japanese Diet held in 1978, MOF officials repeatedly stated that the selling of government bonds at offices of banks is one of the businesses originally permitted to banks.⁷⁰ But, more recently, in 1980, former MOF officials expressed substantial doubts about this interpretation of the MOF and asserted that securities business is not included in the related business of banks.⁷¹ Moreover, when MOF officials explained the "three basic principles" to the banking industry on January 8, 1981, they commented that although the Banking Department of the MOF has held the above interpretation in the past, it is possible that this opinion cannot be sustained under the Securities and Exchange Law.⁷² The MOF's interpretation of whether securities business is included in the related business of banks was changed after the submission of the Committee and the Council Reports; rumor has it that the "three basic principles" were formulated in August 1980.

2. *Under the Securities and Exchange Law.* Article 65(1) of the Securities and Exchange Law⁷³ prohibits banks, trust companies and other such financial institutions as are prescribed by a Cabinet Order, from engaging in any of the businesses set forth in article 2(8), which lists the following businesses:

- (i) sale and purchase of securities,
- (ii) acting as intermediary or agent with respect to the sale and purchase of securities,
- (iii) acting as intermediary or agent with respect to sale and purchase transactions at a securities exchange (including similar markets for securities located in foreign countries),
- (iv) underwriting of securities,
- (v) secondary sale of outstanding securities, and
- (vi) handling of the placement or secondary sale of securities.

The Securities and Exchange Law expressly creates four exceptions to this prohibition:

- (i) Banks may purchase or sell securities upon written order from and for the account of customers;⁷⁴
- (ii) Banks, trust companies and such other financial institu-

70. See, *Hearings Before the Budget Comm. of the Upper House*, 30 (Mar. 27, 1978) (statement of Takashi Tanaka, Director of the Finance Dept. of the MOF). See also, *Hearings on Finance and Securities Before the Subcomm. on Finance and Securities of the Finance Comm. of the Lower House*, 84th Diet, 11 (June 13, 1978) (Statement of Hiromi Tokuda, Director of the Banking Dept. of the MOF).

71. *Hearings on Finance and Securities Before the Subcomm. on Finance and Securities of the Finance Comm. of the Lower House*, 93rd Diet, 5 (Dec. 5, 1980) (Statement of Takashi Ōtsuki, Deputy Chairman of the Securities Exchange Council); also, *id.* at 6 (Statement of Yutaka Tanimura, Chairman of Tokyo Stock Exchange).

72. KINYŪ ZAISEI JIJŌ, Jan. 19, 1981, at 10.

73. SEL, note 9 *supra*.

74. Securities and Exchange Law, *supra* note 9, proviso to art. 65(1).

tions as are prescribed by a Cabinet Order may purchase or sell securities for investment purposes in accordance with the provisions of other applicable laws;⁷⁵

- (iii) Trust companies may purchase or sell securities for the account of the trustor pursuant to a trust agreement;⁷⁶
- (iv) National government bonds, local government bonds, and such corporate or other bonds as are guaranteed by the national government as to repayment of principal and payment of interest (hereinafter collectively called "government bonds") are exempted from the prohibition.⁷⁷

Many scholars and commentators interpret article 65(2) to mean that banks may engage in securities business with respect to government bonds because they are less risky than other bonds. There are varying opinions on this topic. However, most authorities agree that the sale and purchase of securities by banks for the purpose of obtaining necessary funds for their banking operations or for investing idle funds are not considered to be sales and purchases of securities prohibited by article 65, because these activities are typically undertaken by any corporation and are considered to be made for investment purposes.⁷⁸ For example, it is generally considered permissible for banks to engage in the purchase and sale of securities on the repurchase agreement market.⁷⁹

Short-term fund companies mainly engage in lending call money and in the brokerage of such lending under the Law Concerning Supervision of Acceptance of Contribution, Deposits and Interest Rates.⁸⁰ However, when the Bank of Japan began to sell short-term government bonds, the short-term fund companies purchased bonds from the Bank of Japan for resale to banks and securities companies, *i.e.* they traded short-term government bonds, which is one of the securities businesses prohibited to financial institutions. Banks, too, bought these short-term govern-

75. *Id.*

76. *Id.*

77. *Id.*, art. 65(2).

78. SATAKE AND HASHIGUCHI, *supra* note 68, at 154. See also *Hearings on the Bill Before the Finance Comm. of the Lower House*, 94th Diet, 34 (May 13, 1981) (Statement of Hiroshi Yonesato, Director of the Banking Dept. of the MOF).

79. A repurchase agreement (*Gensaki*) is a contract for sale and purchase of securities on the condition that after a specified period of time the purchaser will sell back and the seller will repurchase the securities at a price which consists of the original price plus interest at a stipulated rate for the foregoing period. During this period, the seller can use the funds and the purchaser can earn interest. Thus, the repurchase agreement functions as a means of short-term financing secured by securities. With regard to regulations concerning repurchase agreements in Japan, see notes 152-155 & accompanying text *infra*.

80. *Shusshi no Ukeire, Azukarikin oyobi Kinri tō no Torishimari tō ni Kansuru Hōritsu* (Law No. 195 of 1954). Short-term fund companies are one of the financial institutions designated by the MOF as subject to article 65(1) of the SEL.

ment bonds for resale purposes. It is not clear how these activities can be reconciled with article 65 of the Securities and Exchange Law.

3. *Under the Long-Term Credit Bank Law.* The Long-Term Credit Bank Law⁸¹ was promulgated in 1952 to create banks which specialize in long-term financing by issuing bonds. Among the various other business activities of long-term credit banks, article 6 of the Long-Term Credit Bank Law lists:

Acquisition by subscription or any other method of national government bonds, local government bonds, corporate bonds and other bonds, stocks or contribution certificates, except for acquisition for the purpose of secondary sale of corporate bonds and other bonds (except for bonds which are guaranteed by the national government as to the repayment of principal and payment of interest), stocks or certificates representing equity contribution.

Accordingly, it is generally believed that long-term credit banks may engage in the selling of newly issued government bonds and trading of outstanding government bonds.⁸² It should be emphasized that the above activities of long-term credit banks are their principal business, rather than related business.

4. *Under the Trust Business Law.* Trust banks are ordinary banks which engage in the trust business under the Trust Business Law.⁸³ Article 5 of the Trust Business Law permits trust companies to engage in handling the placement of government bonds, corporate bonds or stocks, the receipt of payment therefor, and activities as paying agent with respect to principal, interest or dividends thereon. The law is partly superceded, though, by article 65 of the Securities and Exchange Law, which prohibits banks and certain other financial institutions from engaging in handling the placement of corporate bonds or stocks. Trust banks are left free to engage in handling the placement of government bonds.

5. *In Commercial Practice.* Before World War II, national government bonds were underwritten by a syndicate of major banks, but when this type of issue became difficult because of excessive issues, the government caused the Bank of Japan, the na-

81. Long Term Credit Bank Law, note 16 *supra*.

82. M. KONDŌ, CHŌKI SHINYŌ GINKŌHŌ (Long-Term Credit Bank Law) 175 (hereinafter "KONDŌ"); *Chōki Shinyō Ginkō no Itonamiuru Shōkengyomu no Hani ni Tsuite*. (Scope of Securities Business Which May Be Engaged in by Long-Term Credit Banks) para. 4 (Interpretation of March 28, 1952 agreed upon by the Banking Dept. of the MOF and the Securities Exchange Committee), *reprinted in* KONDŌ at 176.

83. Trust Business Law, note 18 *supra*.

tion's central bank, to underwrite almost all of the national government bonds. This measure worked well at first, but increases in interest payments and defense expenditures brought about inflation and financial collapse.

After World War II, in view of the financial history of the pre-war period, the Finance Law⁸⁴ severely limited issues of national government bonds in the following two respects:

- (i) The Government may, to the extent approved by the Diet, issue bonds for the purpose of raising funds for public construction works and related activities ["Construction Bonds"] but not to finance government deficits ["Deficit Bonds"],⁸⁵ and
- (ii) Underwriting by the Bank of Japan is generally prohibited.⁸⁶

In accordance with this restriction, no national government bonds were issued⁸⁷ until 1965, when the issue of Construction Bonds was resumed. In 1975, a special law⁸⁸ to authorize the issuance of Deficit Bonds was enacted, and Deficit Bonds have been issued every year since then. As of March 31, 1981, the total amount of outstanding national government bonds was 71.3 trillion yen; the expected amount of new issue for fiscal 1981 is 15.4 trillion yen; and the ratio of government bonds issued to the general account expenditure⁸⁹ has exceeded 30% for each year since fiscal 1977.⁹⁰

The national government bonds issued on April 20, 1981 were underwritten by the following groups to the extent shown:⁹¹

securities companies	33.7%
city banks	26.0%
local banks	13.2%
long-term credit banks	6.8%
trust banks	4.5%
foreign exchange banks	0.9%
others	14.9%

Until recently, underwriting by securities companies (cur-

84. Finance Law, note 66 *supra*.

85. *Id.*, art. 4.

86. *Id.*, art. 5.

87. Exceptions were short-term bonds, foreign currency bonds, bonds issued for reborrowing and bonds issued to compensate loss or damages resulting from World War II.

88. *Shōwa Gojū Nendo ni okeru Zaisei Shori no Tokubetsu Sochi ni kansuru Hōritsu* (Law Concerning Special Measures for Finance in Fiscal Year 1975).

89. The national accounts are divided into general and special accounts. A special account may be established by an act of the Diet.

90. H. KAIZUKA, *et al.*, *NIHON KEIZAI TO KINYŪ SHŌKEN* (Japanese Economy and Finance—Securities) 100, 135, 140 (1981).

91. *Ritsuki Kokko Saiken (Junen) (Dai-35-kai) Hikiuke-dan Keiyaku Shōsho* (*Agreement Among Underwriters Concerning National Government Bonds (10 years)* (No. 35)), dated Apr. 4, 1981.

rently only securities companies may handle the placement of bonds to the public) accounted for only 10% each issue. The remaining amounts were underwritten by other financial institutions which were half-forced by the government to do so. The interest rate on such bonds is determined by the government, not by the going market rate. The bond amounts to be underwritten by each institution are determined by the funds available to the institution for lending, rather than by the institution's demand for such bonds. Thus, it is sometimes said that national government bonds can be compared with feudal contributions.

Because the interest rate on government bonds is kept below the going market rate, for several years the MOF used administrative guidance to prohibit the sale of government bonds underwritten by banks so that the market price of such bonds would not fall.⁹² In practice, though, the Bank of Japan sought to decrease the banks' burden by buying up such bonds from the banks one year after the bonds' issuance. Since 1977, when the market interest rate went down, the sale of government bonds by banks on bond markets has been allowed.⁹³ Now, banks sell on the market approximately three-fourths of the bonds they underwrite. In order to maintain the price of bonds, the Bank of Japan conducts purchasing operations for those bonds using special account funds.

Since the authorization of Deficit Bond issuance in 1975,⁹⁴ the amount of government bonds issued for each fiscal year has increased significantly. As of March 31, 1978, city banks held government bonds in the amount of 6 trillion yen which accounted for 6.1% of the city banks' total assets.⁹⁵ In fiscal 1979, the amounts of national government bonds underwritten by all the city banks accounted for 103% of the total amount of the increase in deposits for the same period of all the city banks.⁹⁶ This caused the funds position of city banks to worsen. In 1979, the market price of government bonds dropped substantially. Under the Uniform Accounting Standards for Banks,⁹⁷ banks were re-

92. This fact was officially denied by the Director of the Finance Dept. of the MOF. *Hearings on Tax and Finance Before the Finance Comm. of the Upper House*, 80th Diet, 21 (Mar. 10, 1977) (Statement of Yoshiro Iwase, Director of the Finance Dept. of the MOF).

93. *Nihon Keizai Shimbun*, Apr. 10, 1977.

94. See note 88 *supra*.

95. M. ENOMOTO, *KOKUSAI* (Government Bonds) 153 (1979).

96. *Hearings on Finance and Securities Before the Subcomm. on Finance and Securities of the Finance Comm. of the Lower House*, 93rd Diet, 33 (Oct. 23, 1980) (Statement of Takuji Matsuzawa, President of The Fuji Bank, Ltd.).

97. Directive of the Director of Banking Dept. of MOF, *Ginkō no Keiri Kijun ni Tsuite* (Concerning Uniform Accounting Standards) (Kura-Gin No. 1507, Sept. 30, 1967).

quired to record government bonds at the lower of cost or market.⁹⁸ Thus, the decrease in the market price of government bonds had a significant adverse effect on the banks' business results. In order to cope with the issuance of huge amounts of national government bonds which started in 1975, many had advocated that individuals be encouraged to purchase government bonds. In 1968, the government created individuals' tax-free holding accounts for government bonds with a ceiling amount of 500,000 yen; in 1974 this ceiling was raised to 3 million yen.⁹⁹ Mid-term national government bonds were introduced in 1977. In order to promote the purchase of government bonds by individuals and in order to reduce the banks' burden of holding government bonds, it has been asserted for several years that banks ought to be allowed to sell and purchase government bonds directly to and from individuals. This would relieve banks of the necessity of selling these bonds through an intermediary securities company.

C. Securities Business In Government Bonds After the 1981 Amendments

1. *Under the New Banking Law.* The New Banking Law substantially rewrote the provisions relating to the businesses in which banks may engage. Under the Old Banking Law, the provisions relating to the scope of the banking business are simple; only one business, *i.e.* safe deposit, is set forth as an example of a "related business" for banks. On the other hand, the New Banking Law enumerates ten businesses as examples of "related business" and expressly provides that banks may engage in the securities business with regard to government bonds.

a. *Types of Business in Which Banks May Engage.* The business of banks under the New Banking Law can be divided into three categories: principal business, related business and other unrelated business.

(1) *Principal Business.* Article 10(1) provides that banks may engage in the following business:

- (i) receiving of deposits or time reserve deposits,¹⁰⁰
- (ii) lending of funds or discounting of drafts, and

98. In December 1979, the Uniform Accounting Standards for Banks was changed so that banks may elect (but only with regard to government bonds) either (a) the cost method or (b) the lower-of-cost-or-market method. Directive of the Director of Banking Dept. of MOF, *Change in the Uniform Standards for Banks* (Kura-gin No. 3110, Dec. 28, 1979).

99. *Sozei Tokubetsu Sochi Hō* (Tax Special Measures Law) art. 4 (Law No. 26 of 1957).

100. Time reserve deposits are defined as money to be received at a specified time,

(iii) exchange transactions.

These are the traditional lines of banking business which are denoted as "principal business". With the single exception of the reference to time reserve deposits, these provisions are identical to those of the Old Banking Law.

(2) *Related Business*. Article 10(2) provides that, in addition to the business provided in paragraph 1 of article 10 banks may engage in businesses which are "related" to banking. As examples, the following activities are listed:

- (i) guarantee of debts or acceptance of drafts;
- (ii) sale and purchase of securities (limited to those which are made for investment purposes or upon the written order and for the account of customers);
- (iii) loan of securities;¹⁰¹
- (iv) underwriting (except underwriting which is for the purpose of secondary sale) of Government Bonds or handling the placement of Government Bonds so underwritten;
- (v) acquisition or transfer of monetary obligations (including negotiable certificates of deposit and such other obligations represented by certificates as prescribed by an order of the MOF);
- (vi) providing administrative services in connection with the placement of local government bonds or corporate or other bonds and acting as trustee for holders of such bonds;
- (vii) acting as agent for banks and other persons engaging in financial business (limited to those which are prescribed by an order of the MOF);
- (viii) acting as depository of money for the national government, local governments, corporations and others and handling of other business related to such money;
- (ix) safe deposit of securities, precious metals and other articles; and
- (x) exchange of currency.

As expressly provided in such article 10(2), these ten lines of business are only examples of related businesses. Accordingly, banks may engage in any other business activities so long as they are related to the banking business. It is said that one such other related business would be the sale and purchase of gold bullion.¹⁰²

In order for banks to engage in the line of business set forth

or at several times during a specified period on the condition that certain amounts of money shall be paid on or before a specified date.

101. The law sometimes requires a person who wants to engage in certain business to deposit securities as security. Banks loan these securities to such persons.

102. *Hearings on the Bill Before the Finance Comm. of the Lower House*, 94th Diet, 16 (May 8, 1981) (Statement of Hiroshi Yonesato, Director of the Banking Dept. of the MOF).

in item (iv) above, no validation is required under the New Banking Law. However, under the 1981 SEL Amendment, a validation is required with regard to handling the placement of government bonds underwritten not for the purpose of secondary sale, if such act is done as a business for profits.¹⁰³

(3) *Other Unrelated Business.* In addition to the securities business set forth in article 10(2)(iv), article 11 of the New Banking Law provides that to the extent the performance of principal business is not interrupted, banks may engage in underwriting, handling the placement or secondary sale, sale and purchase and other business with respect to government bonds. If a bank wishes to engage in any of these activities "as against the public", such bank must obtain a validation from the Minister of Finance.¹⁰⁴ A bank must obtain such a validation under the 1981 SEL Amendment if it contemplates conducting any of the aforementioned activities "as a business for profits".¹⁰⁵ Thus, there would appear to be a conflict between the two laws as to when a validation must be obtained.

To conduct business "as against the general public" means to buy from, and to sell to, the general public. To conduct activities "as a business for profits" has been interpreted to mean the continuous and repeated conduct of an act "as against the general public".¹⁰⁶ There does not appear to be much difference between the two conditions. Therefore, the net effect is that banks are not required to obtain validations under either of these provisions if they only sporadically make private placements of bonds underwritten by them.

b. *Summary of Permitted Activities.* First, banks may underwrite government bonds, as long as the purpose is not secondary sale.¹⁰⁷ In the past, such underwriting has been conducted by banks with regard to national government bonds and has been classified as one of the related businesses of banks. No license or validation from the Minister of Finance will be needed for such activity under either the New Banking Law or the amended Securities and Exchange Law.

103. 1981 SEL Amendment, note 51 *supra*; incorporated at SEL, *supra* note 9, art. 65-2.

104. Art. 5 of the Supplementary Provisions to the New Banking Law, note 1 *supra*.

105. 1981 SEL Amendment, note 51 *supra*; incorporated at SEL, *supra* note 9, art. 65-2.

106. Statement of Hiroshi Yoshimoto, Director of Securities Dept. of MOF, at the joint meeting of the Financial Problem Research Committee and the Finance Committee of the Liberal Democratic Party held on March 6, 1981.

107. New Banking Law, *supra* note 1, art. 10(2)(iv).

Second, banks may engage in handling the placement of government bonds underwritten by them without the purpose of secondary sale.¹⁰⁸ This business has not been done by banks because of the provision in the Supplemental Agreement Among Underwriters to the effect that no underwriter other than a securities company shall handle the placement of government bonds. This business is classified as one of the related businesses of banks. In this case, it is not necessary to obtain any license or validation from the Minister of Finance under the New Banking Law. However, banks are required to obtain validations under the Securities and Exchange Law, as amended, if they intend to conduct such business for profit.¹⁰⁹

Lastly, banks may engage in underwriting, handling the placement or secondary sale, sale and purchase and other business with regard to government bonds (other than underwriting of government bonds without secondary sale purpose and handling the placement of government bonds so underwritten).¹¹⁰ These businesses are classified as one of the other unrelated businesses of banks and may be engaged in by banks only so long as the conduct of these businesses does not interfere with any of the principal businesses.¹¹¹ In this case, banks must obtain validations from the Minister of Finance under both the New Banking Law and the amended Securities and Exchange Law.

2. *Under the 1981 Securities and Exchange Law Amendment.* As mentioned above, the Securities and Exchange Law has been amended to require that if banks, trust companies and certain other financial institutions¹¹² wish to engage in certain securities business¹¹³ with respect to government bonds, such financial institutions must first obtain a validation from the Minister of Finance.¹¹⁴ The provisions in the Securities and Exchange Law regarding types of, conditions and standards for securities busi-

108. *Id.*, art. 10(2)(iv).

109. 1981 SEL Amendment, note 51 *supra*; incorporated at SEL, *supra* note 9, art. 65-2.

110. New Banking Law, *supra* note 1, art. 11.

111. *Id.*

112. Such other financial institutions would be prescribed by a Cabinet Order.

113. Such securities business means activities set forth in art. 2(8) of the Securities and Exchange Law, note 9 *supra*, provided that the sale and purchase of securities upon the written order and for the account of customers, and sale and purchase of securities by financial institutions for investment purposes or for the account of a trustor pursuant to a trust agreement are excluded; and provided, further, that with regard to underwriting, this paragraph applies only to such underwriting as is made for the purposes of secondary sale.

114. Such validation shall be applied pursuant to the provisions of a Cabinet Order stating the contents and method of the business in which such financial institutions wish to engage.

ness licenses are applied *mutatis mutandis* to validations of securities business by financial institutions.¹¹⁵ Moreover, financial institutions which have obtained validations are subject to provisions that regulate securities transactions by securities companies.¹¹⁶ In addition, when it is deemed necessary and appropriate, the Minister of Finance may order financial institutions which have obtained validations to submit reports or materials concerning business or assets relating to the validations, or may cause MOF personnel to examine the condition of such business or assets or its books, records and other articles.¹¹⁷ These provisions are said to be necessary from the standpoint of the protection of investors, a consideration which is not necessarily identical to the protection of depositors.

3. *Under the Amendment to the Long-Term Credit Bank Law.* The current Long-Term Credit Bank Law provides that long-term credit banks may acquire government bonds by subscription or by any other method.¹¹⁸ Article 4 of the Law Concerning Adjustments of Related Laws Required by the Enforcement of the New Banking Law¹¹⁹ amended the Long-Term Credit Bank Law by inserting a section providing that long-term credit banks may, as a related business, engage in the sale and purchase and any other business with respect to government bonds.¹²⁰

But several ambiguities remain. Word usage is not consistent between the New Banking Law and the amended Long-Term Credit Bank Law. First, it is not clear whether handling the placement of government bonds is included in the business of long-term credit banks, because unlike the New Banking Law, the amended Long-Term Credit Bank Law does not specifically provide for handling the placement of bonds. It would appear that handling the placement of government bonds is included in "acquisition of government bonds", which is one of the principal businesses of long-term credit banks and which is a business for which long-term credit banks have been granted licenses by the Minister of Finance. Nevertheless, it is unclear whether long-term credit banks must obtain a validation from the MOF before handling the placement of government bonds. Also unclear is

115. 1981 SEL Amendment, note 51 *supra*; incorporated at SEL, *supra* note 9, art. 65-2(2).

116. *Id.*; incorporated at SEL, *supra* note 9, art. 65-2(3).

117. *Id.*; incorporated at SEL, *supra* note 9, art. 65-2(5).

118. Long-Term Credit Bank Law, *supra* note 16, art. 6(1)(ii).

119. *Ginkōhō no Shikō ni tomonau Kankei Hōritsu no Seibi tō ni kansuru Hōritsu* (Law No. 61 of 1981; hereinafter, "Adjustment Law").

120. Incorporated at art. 6(3)(iii) of the Long-Term Credit Bank Law, note 16 *supra*.

whether long-term credit banks may handle the placement of corporate bonds underwritten by them without a secondary sale purpose.¹²¹

D. The Three Basic Principles Behind the New Banking Law

The provisions in the New Banking Law relating to the securities business by banks are based on the so-called "three basic principles" formulated by MOF. The three basic principles were disclosed to the banking industry before the draft of the new banking law bill was made public and were the central focus of discussions and negotiations concerning provisions on the securities business of banks.

The three basic principles were agreed upon by various sections of the MOF (mainly, the Banking and the Securities Departments). There is no official statement incorporating them, but it was generally understood that the three basic principles were:

- (i) The proposed new banking law would expressly allow banks to engage in the securities business with respect to government bonds;
- (ii) Validation under the Securities and Exchange Law would be required for, and necessary regulations thereunder would be applied to, the securities business done by banks; and
- (iii) The amendment would establish the system under which banks could engage in securities business; however, when banks might actually start to conduct securities business would be determined at a later date.

The only written official material which includes the three basic principles is a statement entitled "Positioning of Securities Business by Banks" which was distributed by officials of the MOF's Banking Department at a meeting of the Securities Committee of the National Federation of Bank Associations on January 8, 1981.¹²²

121. KONDŌ, *supra* note 82 at 175. The author answers in the affirmative.

122. See note 10 *supra*. The statement set forth the following eight items:

- (a) The entire amendment of the Old Banking Law and other amendments of related laws (including the Securities and Exchange Law) will be submitted during the current terms of the Diet;
- (b) An express provision regarding securities business by banks with respect to government bonds will be inserted in the proposed new banking law;
- (c) Banks will be allowed to continue to conduct those activities which are now actually conducted by banks in relation to securities;
- (d) Those lines of business related to securities which are now actually conducted by banks (such as underwriting pursuant to the Underwriting Syndicate Agreement) will be classified as one of the related businesses;
- (e) Such business as selling newly issued government bonds at bank offices and trading of outstanding government bonds will be positioned as new business, which is not classified either as "principal business" or "related business" (in this sense, it is one of the other unrelated businesses);

1. *The First Basic Principle.*

a. *The Committee Report's View.* It is unclear where the three basic principles were developed. The Committee Report does not state the three basic principles. The Committee Report does state that because the ratio of government bonds owned by financial institutions to the total assets of financial institutions has been increasing, it is necessary for banks to be able to engage in the sale and purchase of government bonds as a means of managing their own assets.¹²³ Also, to permit banks to offer newly-issued government bonds through their branch networks¹²⁴ would promote the purchase of government bonds by individuals and diversify the choice of investment assets for individuals. The Committee Report left to the administrative authorities the regulation of securities business by banks, stating that the precise nature of the securities business which may be engaged in by banks should be discussed further among the administrative authorities.¹²⁵

Taken as a whole, the Committee Report favors allowing banks to engage in the securities business, and no statement can be found in the Committee Report which suggests that validations should be required for banks to engage in securities business or that there should be a waiting period before banks actually may conduct such business. The Council Report, however, agrees with the securities industry's view.

b. *The Council Report's View.* The Council Report states that to allow banks to deal in government bonds will not solve the problems of the bond market because those problems resulted

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- (f) With regard to the business referred to in (e) above, validations under the proposed new banking law will be required so long as such business is conducted as against the general public, so that it may not impair the sound management of banks. Also, in view of the fact that securities companies are required to obtain licenses, validations under the Securities and Exchange Law will be required and necessary regulations thereunder will be applied;
 - (g) It is considered appropriate that both banks and securities companies may engage in securities business with regard to short-term securities, but how to effectuate this plan will be discussed at a later time;
 - (h) The foregoing system must first be established; the enforcement thereof will be discussed thereafter.

It should be noted that this statement changed the previous official interpretation of the MOF regarding the legality of securities business by banks. The MOF justified its change by saying that it is likely that the previous interpretation cannot be sustained under the Securities and Exchange Law and that when the MOF asked the Ministry of Justice for an official opinion on this issue, the Ministry of Justice declined to issue such opinion. See note 72, *supra* and accompanying text.

123. Committee Report, *supra* note 5 at 21 of Part I.

124. *Id.* at 22 of Part I.

125. *Id.* at 77 of Part I.

from banks being forced to purchase a disproportionate share of the government bonds issued.¹²⁶ The Report also states that before banks are allowed to trade in government bonds, it is necessary to decide which other financial institutions will be allowed to deal in government bonds and to discuss what regulation should be imposed on such institutions in order to maintain the fair and smooth operation of the bond market.¹²⁷

The Council Report also states that to allow banks to handle the placement of newly issued government bonds would not effectively promote purchases by individuals of government bonds. Furthermore, the stability of holdings by individuals of government bonds is questionable.¹²⁸ The Council Report asserts, too, that the conduct of underwriting by banks would give rise to the same problems as caused by bank involvement in the trading business.¹²⁹ Like the Committee Report, the Council Report makes no specific recommendations; rather, it leaves the regulation problem to the administrative authorities.¹³⁰

c. *The MOF's View.* Usually, the MOF does not publish written justifications for its policy positions. Instead, an official of the MOF explains the reasons for the MOF's position in the form of a personal opinion. Such was the case with the New Banking Law. The only explanation of the official reasoning behind the three basic principles is found in an article written by a senior official in the MOF, Masaaki Tsuchida.¹³¹ Although it is qualified as his personal opinion, it may be considered as an official explanation of MOF policy because the author was deeply involved in the formation of the three basic principles and the drafting of the Bill; also, his explanation was later confirmed by another official of the MOF.¹³²

According to the Tsuchida Article, the reasons for the first of the three basic principles—to allow banks to conduct securities business in government bonds—are that:

- (i) the Securities and Exchange Law exempts government

126. Council Report, *supra* note 7 at 9. Bond ownership should have been more evenly balanced among the individual, corporate and government sectors of the economy.

127. *Id.* at 12.

128. *Id.* at 17.

129. *Id.* at 18.

130. *Id.* at 19.

131. Masaaki Tsuchida, *Shōken Sangensoku wa Kinyūkai no Zenshin eno Fuseki* (The Three Basic Principles Regarding Securities are a Milestone for the Development of the Banking Industry), KINYŪ ZAISEI JIJŌ, Feb. 23, 1981, at 14 (hereinafter cited as "Tsuchida Article").

132. Hiroyuki Shiraishi, *Ginkōhō tōno Kaisei ni Tsuite* (Amendment of the Banking Law, etc.), 909 SHŌJI HŌMU 844 (1981).

bonds from the proscription against banks engaging in the securities business;

(ii) no major country proscribes banks engaging in such securities business; and

(iii) future issue of government bonds will be very difficult without the cooperation of the financial institutions which have been playing a great role in underwriting a significant portion of the government's bonds.¹³³

There does not seem to be much difference of opinion between the MOF and the banking industry concerning the first of the three basic principles. However, as noted earlier, the MOF has changed its previous opinion as to whether banks may engage in securities business; it currently holds that securities business by banks is not a related business.¹³⁴ The banking industry, on the other hand, takes the position that securities business is included in the related business of banks¹³⁵ and accordingly the new provisions merely confirm the previous interpretation.

d. *The Securities Industry's View.* The securities industry strongly objected to the first of the three principles on the grounds that:

(i) banks have strong influence over their customers and may tend to force them to purchase government bonds;

(ii) banks cannot be expected to determine bond prices fairly because as holders of huge amounts of bonds, banks are both sellers of, and investors in the bonds that are to be priced;

(iii) securities companies have made and will make every effort to sell government bonds to individuals and will be able to cope effectively with the huge amount of issues expected in 1982 and thereafter; and

(iv) the entry of banks into the securities business will have a significant adverse effect on the securities industry, which does not yet have a strong foothold and needs to be protected.¹³⁶

2. *The Second Basic Principle.* The reason given for the second principle—that a validation under the Securities and Exchange Law should be required—is that if banks are to engage in the same line of business as securities companies they should be subject to the same rules as securities companies.¹³⁷ The latter are

133. Tsuchida Article, *supra* note 131 at 18.

134. See note 72 *supra* & accompanying text.

135. Banking Association Opinion, *supra* note 11 at 20.

136. *Hearings on the Bill Before the Finance Comm. of the Upper House*, 94th Diet, 4 (May 18, 1981) (Statement of Kiichiro Kitaura, Chairman of the Japan Securities Industry Association). See also *Hearings on Finance and Securities Before the Subcomm. on Finance and Securities of the Finance Comm. of the Lower House*, 93rd Diet, 1 (Dec. 5, 1980) (Statement of Kiichiro Kitaura, Chairman of the Japan Securities Industry Association).

137. Tsuchida Article, *supra* note 131 at 19.

required to obtain licenses to engage in the securities business, and transactions conducted by securities companies are subject to various regulations under the Securities and Exchange Law and orders issued thereunder. Although banks are already subject to banking regulations which aim to protect depositors, securities regulations which aim to protect investors are not necessarily identical to banking regulations. However, banks may, without validation, conduct those acts which they have been conducting in relation to government bonds.

3. *The Third Basic Principle.* According to this principle, the new law should not state when banks will be able to obtain validations to engage in securities business. Instead, the operation of the system should be discussed and determined by the administrative authorities after enactment of the law that permits banks to engage in such business. To discuss the details of the regulatory system's operations, it was argued, could prevent establishment of any system to regulate banks in the securities business.¹³⁸

So far as banks are concerned, it does not seem to be necessary to restrict the number of banks which should be granted validations. There has been speculation that although the effective date of the New Banking Law is expected to be April 1, 1982, no validations will be granted until 1983 at the earliest, because that is when the ten-year term government bonds issued in 1975 will become two-year term bonds and, therefore, competitive with the two-year time deposits offered by banks.¹³⁹ On October 6, 1981, the three-member board which is to discuss and recommend to the Minister of Finance the time to begin granting validations held its first meeting.

In light of the foregoing, it appears that protection of the securities companies' interests is the primary reason for basing the 1981 changes on the three basic principles. To do so was a recognition that securities companies have not yet established a strong groundwork for profitable management.

E. Related Businesses Conducted By Banks

Like their U.S. counterparts, Japanese banks may acquire corporate bonds for their own accounts for investment purposes. However, unlike U.S. banks, they may also acquire stocks issued by corporations. The only restrictions in this regard are those imposed by the Antimonopoly Law, which prohibits banks from acquiring more than five percent of the outstanding stock of a

138. *Id.* at 20.

139. NIHON KINYŪ TsŪSHIN, May 11, 1981.

domestic corporation.¹⁴⁰

1. *Negotiable Certificates of Deposit*. Prior to May 1979, the MOF did not allow banks to issue negotiable certificates of deposit ("CD's"). However, in accordance with a recommendation of the Committee, the MOF lifted this prohibition in May 1979. Various conditions were attached to CD issues, the most significant of which were as follows:¹⁴¹

- (i) the face amount must be 500 million yen or more;
- (ii) the maturity must be not shorter than three months but not longer than six months;
- (iii) no bank may issue negotiable certificates of deposit in a total outstanding amount in excess of a certain percentage of its capital and surplus (currently 50%);
- (iv) the interest is exempted from interest regulation¹⁴² under the Temporary Interest Rate Adjustment Law;¹⁴³ and
- (v) financial institutions, short-term fund companies and affiliates of financial institutions may engage in the sale and purchase of negotiable certificates of deposit and brokerage of such sale and purchase.

The trading market for negotiable certificates of deposit has been growing rapidly and has become a significant short-term fund market, supplementing the call money, draft discount and repurchase agreement markets.¹⁴⁴

Currently, trading in CD's that are issued in foreign countries is prohibited by the MOF. This prohibition will be lifted in April 1982.¹⁴⁵ The 1981 SEL Amendment included provisions that would permit securities companies to trade negotiable certificates of deposit issued in foreign countries.¹⁴⁶ Although the 1981 SEL Amendment does not limit the scope of the CD's, the MOF has taken the position that for the time being, only those CD's which are issued in foreign countries may be traded by securities companies. On the other hand, banks are now trading CD's issued in

140. Antimonopoly Law, *supra* note 27, art. 11.

141. Director of the Banking Dept. of MOF, *Jōtosei Yokin no Toriatukai ni Tsuite* (Negotiable Certificates of Deposit) (Kura-Gin No. 650, Mar. 30, 1979).

142. *Rinji Kinri Chōsei Hō ni Motozuku Kinyūkikan no Kinri no Saikōgendo ni Kansuru Ken* (Limitations on Interest Rates of Financial Institutions under the Temporary Interest Rate Adjustment Act) (MOF Notification No. 4 of 1948).

143. *Rinji Kinri Chōsei Hō* (Temporary Interest Rate Adjustment Law) (Law No. 181 of 1947).

144. *Nihon Keizai Shimbun*, Aug. 7, 1981, at 3.

145. The New Banking Law sets forth as one of the related business of banks acquisition or transfer of monetary obligations (including CD's and such other obligations represented by certificates as prescribed by a MOF Order). New Banking Law, *supra* note 1, art. 10(2)(v).

146. 1981 SEL Amendment, note 51 *supra*; incorporated at SEL, *supra* note 9, art. 43. See note 60 & accompanying text.

Japan and as of April 1, 1982 will be able to trade CD's issued in foreign countries.

2. *Commercial Paper*. At present, Japanese corporations are not allowed to issue commercial paper on the ground that the legal regime to govern commercial paper has not been established.¹⁴⁷ For example, it is unclear whether commercial paper rules should be like those for bonds or those for promissory notes. Also undetermined are disclosure requirements to be imposed on issuers.¹⁴⁸ However, one order of the MOF promulgated under the Foreign Exchange Law already mentions commercial paper.¹⁴⁹ The New Banking Law and the concurrent amendment to the Securities and Exchange Law make it possible for banks and securities companies to trade commercial paper.¹⁵⁰ However, the MOF's position on this subject is that, for the time being, only commercial paper which is issued in foreign countries may be traded in by banks and securities companies.¹⁵¹

3. *Repurchase Agreements (Gensaki)*. A repurchase agreement¹⁵² takes the form of a conditional sale and purchase of securities, but in fact it is a means of short-term finance. To the purchaser, it is investment of funds which are not immediately needed; to the seller, it is a way of using longer-term investments to obtain short-term financing. Any corporation may conclude repurchase agreements as one of its corporate activities. The agreements are not considered to be a sale and purchase of securities which would be off limits to banks under the Securities and Exchange Law, but they are considered as sale and purchase of securities for investment purposes.¹⁵³ Thus, banks may engage in such sales and purchases of securities as are made for the purpose of repurchase agreements.

MOF did not regulate the repurchase agreement market until March 1976, when the Director of the Securities Department of the MOF issued a directive entitled "Handling of Repurchase Agreements".¹⁵⁴ This directive was addressed to the Chairman of the Japan Securities Industry Association and requests that mem-

147. Nihon Keizai Shimbun, May 19, 1981.

148. See note 60 *supra*.

149. See note 62 *supra*.

150. New Banking Law, *supra* note 1, art. 10(2)(v). 1981 SEL Amendment, note 51 *supra*; incorporated at SEL, *supra* note 9, art. 43.

151. See note 60 *supra*.

152. See note 79 *supra*.

153. SEL, *supra* note 9, art. 65(2). See note 79 *supra*.

154. Director of the Securities Dept. of the MOF, *Saiken no Jōken-tsuki Baibai no Toriatsukai ni Tsuite* (Handling of Repurchase Agreements) (Kura-sho No. 287, March 10, 1976).

ber companies comply with certain business standards relating to agreements, customers, securities to be traded, prices, periods and balances in connection with the trading of repurchase agreements.

In contrast to the call money and draft discount markets in which only banks and short-term fund companies may participate, the repurchase agreement market has been a market which is open to various corporations. At first, banks were not allowed to participate in the repurchase agreement market, but in October 1978, banks were permitted to procure operating funds from the repurchase agreement market within certain upper limits. In April 1980, these ceilings were lifted. In April 1981, the Bank of Japan allowed banks to make purchases in the repurchase agreement market.¹⁵⁵ It should be noted that in November 1980, the Bank of Japan allowed securities companies to procure funds in the call money market. These actions were taken by the Bank of Japan in order to liberalize Japan's short-term financial market.

F. Securities Business by Foreign Subsidiaries of Japanese Banks

As of December 30, 1978, there were 39 foreign subsidiary banks of Japanese banks. Because some countries where these foreign subsidiary banks operate do not prohibit banks from engaging in the securities business, some of these foreign subsidiary banks actually are engaging in the securities business. When one of these foreign subsidiary banks acts as a managing underwriter for an issue of bonds by a Japanese corporation in a foreign market, negotiations made in Japan between the issuing corporation and the parent Japanese bank are likely to constitute underwriting which is prohibited by article 65 of the Securities and Exchange Law. With this in mind, in August 1974, three Departments of the MOF—Banking, Securities and International Finance—jointly formulated a policy for administrative guidance concerning securities business by foreign subsidiaries of Japanese banks. The gist of this guidance is as follows:¹⁵⁶

- (i) The shareholdings of a Japanese parent bank in a foreign subsidiary bank which engages in securities business shall be regulated by the MOF according to the nature of the parent bank, *i.e.*, whether it is a city bank, long-term credit bank, etc.;
- (ii) If a Japanese bank owns both a branch and a subsidiary at the same place, *e.g.* London, the branch shall engage in banking business and the subsidiary shall engage in securities business; and

155. Nihon Keizai Shimbun, Apr. 10, 1981 and May 23, 1981.

156. The MOF has refused to disclose the content of this guidance. The author has relied on an article in Nihon Keizai Shimbun, Feb. 22, 1981, for this information.

- (iii) If a foreign subsidiary bank acts as one of the managers for the issue of securities by a Japanese corporation in a foreign market, a subsidiary of a Japanese securities company must act as a manager for such issue senior to the foreign subsidiary bank.¹⁵⁷

The Committee Report, however, proposed that in order to maintain competitive equality between banks established in countries which do not prohibit banks from engaging in the securities business and Japanese subsidiary banks established in such countries, the MOF should allow such subsidiary banks to engage in any business permitted to local banks.¹⁵⁸ The Report also stated that in view of the separation of the banking business from the securities business under Japanese law, care must be taken to ensure that Japanese parent banks do not themselves virtually engage in the underwriting of bonds issued by Japanese corporations in foreign markets.¹⁵⁹

After the enactment of the New Banking Law, the MOF published a series of measures relating to the liberalization of banking administration.¹⁶⁰ In one of the measures, the MOF made it clear that the foregoing guidance gradually will be abolished. As examples, the release sets forth the following:

- (i) In March 1980, IBJ International Ltd.¹⁶¹ (London) obtained a banking license;
- (ii) In June 1981, Sumitomo Finance International (head office in Switzerland; principal place of business in London) became a 100% subsidiary of The Sumitomo Bank, Ltd. Previously, it had been a 70% subsidiary; and
- (iii) In April 1981, IBJ International Ltd. acted as a managing underwriter for the issue of foreign bonds by The Industrial Bank of Japan, and in May 1981, LTCB International¹⁶² acted as a managing underwriter for the issue of foreign bonds by The Long-Term Credit Bank of Japan.

III. CONCLUSION

The New Banking Law was enacted in accordance with the "three basic principles". The third basic principle, which states that validation standards should be determined only after the legal system is established, is especially questionable. It can only be explained from the standpoint of protecting the interests of the

157. *Id.*

158. Committee Report, *supra* note 5, Part I at 102.

159. *Id.*

160. Banking Dept. of the MOF, *Ginkō Gyōsei no Jiyūka, Danryokuka ni Tsuite* (Liberalization of Bank Administration) (June 25, 1981).

161. IBJ International Ltd. is a subsidiary of The Industrial Bank of Japan, one of the three long-term credit banks.

162. LTCB International is a subsidiary of The Long-Term Credit Bank of Japan, one of the three long-term credit banks.

securities industry by delaying the full entry of banks into the government bond market. It is odd that at the time of the enactment of the New Banking Law, there already was speculation that validations would not be granted until 1983 at the earliest.

In order to persuade the banking industry to agree on the three basic principles, compromises were made in the areas of disclosure requirements and lending limits. When we are reminded that criticism of past bank behavior was one of the two major reasons which necessitated the entire amendment of the Old Banking Law, these compromises are regrettable.

When recent trends in the financial field in the United States and Japan are taken into consideration, it does not seem to be a big problem to allow banks to engage in the securities business with regard to government bonds. In the United States, securities companies offer money market funds or cash management accounts which are depriving banks and savings and loan associations of deposits. In Japan, mid-term government bond funds (which are similar to money market funds) recently have been offered by securities companies, and these accounts are expanding at a brisk pace.

Individuals wish to invest their money in such financial assets as may offer better interest rates and have liquidity. Institutional investors prefer to manage their money at the repurchase agreement market rather than depositing it with banks. In view of these trends, it is inevitable that deposits with accounts that can only offer low interest rates are decreasing. Under these circumstances, it would be desirable for banks to be able to offer a variety of attractive financial assets to individual and institutional investors.

In the past, the Committee returned reports which were favorable to the banking industry, while the Council returned reports favorable to the securities industry. Because the financial world has come to a turning point, it would be necessary and appropriate to establish a new committee which will discuss the future of the financial industry as a whole, including both the banking and securities industries. In particular, such a committee should discuss whether it is desirable to maintain the separation of securities companies and banks, and the separation of ordinary banks and long-term credit banks or trust banks; and if such separation should be eased, to what extent this should be done, and how each type of bank should be regulated.