FAQ on Financial Instruments and Exchange Act

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Financial Services Agency, Japan
FAQ on Financial Instruments and Exchange Act

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### FAQ on Financial Instruments and Exchange Act

**Section 1 Purpose, etc.**

Q. What is the chapter structure of the Financial Instruments and Exchange Act (FIEA)?

A. The chapter structure of the FIEA is as follows.

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Q. What is the structure of the purpose provisions (Article 1) of the FIEA?

A. The structure of the purpose provisions of the FIEA is as follows (Article 1 of the FIEA).

(1) Measures for achieving the purposes
   - Develop systems for disclosure of corporate affairs and other related matters
   - Provide for necessary matters relating to persons who engage in Financial Instruments Business
   - Secure appropriate operation of financial instruments exchanges, etc.

(2) Direct purposes
   - Ensure fairness in issuance of the securities and transactions of financial instruments, etc.
   - Facilitate the smooth distribution of securities
   - Aim at fair price formation of financial instruments, etc. through the full utilization of functions of the capital market

(3) Ultimate purposes
   - Contribute to the sound development of the national economy
   - Contribute to the protection of investors
Section 2 Definitions

Outline

Q. What regulations are invoked where a financial instrument falls under the definition of “Securities” under the FIEA?

A. 1. First, with regard to “Securities” regulations on conducting certain activities in the course of trade (regulations on conducting business) and those requiring or prohibiting the performance of certain activities by business operators (regulations on activities) are applied. Specifically, with regard to “Securities” the regulations on conducting business under the FIEA are applied to such activities as sales and purchases, etc., and, in principle, only persons registered as Financial Instruments Business Operators are permitted to conduct such activities in the course of trade (Article 29 of the FIEA). Financial Instruments Business Operators, etc. are subject to the regulations on activities under the FIEA, and in principle, they have obligations such as to deliver a document to the customer prior to the conclusion of a contract (Article 37-3; Chapter III, Section 2 of the FIEA).

2. Second, disclosure regulation under the FIEA is applied to “Securities” in principle. Specifically, as a disclosure rule in the primary market, with regard to public offering and secondary distribution of securities, issuers of securities, etc. are obligated to facilitate public inspection of securities registration statements by submitting them to the authorities and directly provide information to investors through the delivery of prospectuses. As a disclosure rule in the secondary market, with regard to some types of securities, such as listed securities, issuers of securities, etc. are obligated to facilitate public inspection of annual securities reports, etc. by submitting them to the authorities (Chapter II of the FIEA).

3. Third, with regard to “Securities” provisions that prohibit unfair transactions, including prohibition of wrongful acts (Article 157) and prohibition of spreading rumor, using fraudulent means, committing assault or intimidation (Article 158) are applied (Chapter VI of the FIEA).

4. Fourth, financial instruments exchanges are permitted to handle “Securities” (Article 2(14) and (16), Chapter V of the FIEA).

Q. What are beneficiary securities of beneficiary securities issuing trusts?

A. 1. "Beneficiary securities of beneficiary securities issuing trusts" (Article 2(1)(xiv) of the FIEA) are certificates indicating beneficial interests (beneficiary certificates) of trusts for which issuance of beneficiary certificates is provided for under the terms of trust (beneficiary certificates issuing trusts). The definition is provided for in Article 185 of the Trust Act.

2. The Trust Act provides that securities under private law may be issued with regard to beneficial interests by introducing the system of beneficiary certificates issuing trusts (Chapter VIII of the Trust Act). Meanwhile, the FIEA prescribes beneficiary certificates issuing trusts as securities (Article 2(1)(xiv) of the FIEA).
Q. What kinds of financial instruments are designated as “Securities” by Cabinet Order?

A1. The FIEA allows for additional designation of the securities set forth in Article 2(1) and the "securities equivalents" set forth in Article 2(2) by Cabinet Order (Article 2(1)(xxi) and Article 2(2)(vii) of the FIEA).

2. Specifically, the financial instruments designated as the securities set forth in Article 2(1) of the FIEA are deposit certificates of negotiable deposits issued by foreign judicial persons (Article 2(1)(xxi) of the FIEA; Article 1(i) of the Order for Enforcement of the FIEA (hereinafter referred to as the "FIEA Enforcement Order"); and securities or certificates which indicate certain monetary claims (limited to those that are not nominative claims) against incorporated educational institutions, etc. and indicate matters including the name of the incorporated educational institution, etc. and the amount of the monetary claims (school bonds) (Article 1(i) of the FIEA Enforcement Order; Article 4 of the Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act (Definition Ordinance)). "Those that are not nominative claims" assumes monetary claims of which securities or certificates do not indicate the creditors and are recognized to have the nature of securities as bearer securities under private law (see Supreme Court judgment, June 24, 1969, Minshu Vol. 23, No. 7, p. 1143). They are not considered to include mere certificates of evidence.

3. In addition, the financial instruments designated as the "securities equivalents" set forth in Article 2(2) of the FIEA include claims pertaining to loans that are made to incorporated educational institutions, etc. and that satisfy all of the following requirements (Article 2(2)(vii) of the FIEA; Article 1-3-4 of the FIEA Enforcement Order; Article 8 of the Definition Ordinance):

(1) loans with the same interest rate and due date that are made by multiple persons;
(2) loans made by persons other than interested persons (enrolled students, their parents, etc., graduates, and officers and employees of the incorporated educational institution) or loans of which claims are not prohibited from being transferred to persons other than interested persons; and
(3) loans made by persons other than banks, etc. or loans of which claims are not prohibited from being transferred to persons other than banks, etc. (including collection companies).

Q. Why are deposits and insurance not designated as “Securities”?

A1. Since deposits and insurance are regulated under the Banking Act and the Insurance Business Act, they are not directly regulated under the FIEA by way of designating them as “Securities”.

2. However, according to the basic idea to apply the same user protection rules (sales/solicitation rules) for financial instruments and transactions having the same economic nature, regulations equivalent to regulations on activities are secured for deposits and insurance with a strong investment character, by applying mutatis mutandis the regulations on activities under the FIEA pursuant to the Banking Act and the Insurance Business Act (Articles 13-4 and 52-45-2 of the Banking Act; Article 300-2 of the Insurance Business Act).
3. Meanwhile, financial instruments such as ordinary deposits, time deposits, and security-type insurance have a different economic nature from instruments with a strong investment character as represented by shares and corporate bonds. They do not involve any loss of principal caused by market risks and do not require application of regulations equivalent to regulations on activities for instruments with a strong investment character, so regulations on activities under the FIEA are not applied mutatis mutandis to these instruments. These deposits and insurance have also been subject to the regulations on activities (note) under the Banking Act and the Insurance Business Act.

(Note) Article 12-2 (Provision, etc. of Information to Depositors, etc.) and Article 13-3 (Prohibited Acts Pertaining to Business of Banks) of the Banking Act; Article 100-2 (Measures Concerning Business Operations) and Article 300 (Prohibited Acts Pertaining to Conclusion of Insurance Contract or Insurance Solicitation) of the Insurance Business Act.

Interests in collective investment schemes (funds)

Q. What is the definition for interests in collective investment schemes under the FIEA?

A1. In recent years, due to progress in financial and IT technologies, the introduction of new "vehicles" through development of the legal system, and diversification of fund procurement and investment methods, new fund-type financial instruments which are not subject to existing user protection laws have emerged. In addition, there have been incidents of damage caused by business-type funds taking the form of anonymous partnerships targeting many general investors. Moreover, the Livedoor incident (violations of the Securities and Exchange Act by Livedoor) and other circumstances triggered active debates over investment partnerships and investment funds.

2. In response to such a situation, with a view to filling the regulatory "gaps" for ensuring application of user protection rules, the FIEA provides a comprehensive definition for rights that are categorized as "securities equivalents" (Article 2(2)(v) and (vi) of the FIEA). This comprehensive definition can be referred to as "interests in collective investment schemes (funds)." The FIEA provides for both rights based on domestic laws and regulations (Article 2(2)(v) of the FIEA) and rights based on foreign laws and regulations (Article 2(2)(vi) of the FIEA).

3. As rights based on domestic laws and regulations, the FIEA lists rights based on a partnership contract under the Civil Code, an anonymous partnership agreement under the Commercial Code, an investment limited partnership agreement, or a limited liability partnership agreement, as well as membership rights of an incorporated association (Article 2(2)(v) of the FIEA). These are only listed as examples of vehicles used for a collective investment scheme, and as clear from the phrase of "or other rights," the type of law is irrelevant in determining whether or not a right is categorized as an interest in a collective investment scheme.

4. The definition of an interest in a collective investment scheme consists of the following three elements (Article 2(2)(v) of the FIEA; Article 1-3 of the FIEA Enforcement Order):

(1) the holder of the right (equity investor) invests or contributes money, etc.;
(2) a business is conducted by using the invested or contributed money, etc. ("invested business"); and

(3) the right enables the equity investor to receive dividends from profits arising from the invested business or distribution of the assets of the invested business.

However, because there may be rights that satisfy all of these requirements but do not necessarily need to be regulated under the FIEA, the FIEA excludes certain rights from the definition of interests in a collective investment scheme (Article 2(2)(v)(a) through (d) of the FIEA).

5. The term "collective" investment scheme may give an impression that it only includes schemes in which multiple persons make investments or contributions, but investments or contributions by multiple persons is not a requirement for a collective investment scheme under law. Therefore, a scheme in which a single person makes an investment or contribution can also fall under the comprehensive definition of a collective investment scheme.

Q. What regulations have been prescribed with regard to interests in collective investment schemes?

A1. To fill regulatory "gaps," the FIEA provides a comprehensive definition regarding interests in collective investment schemes (Article 2(2)(v) and (vi) of the FIEA) and treats the schemes as securities. As a result, various regulations under the FIEA are applied to collective investment schemes.

2. First, disclosure regulation is applied to public offering or secondary distribution of interests in so-called investment-type collective investment schemes ("rights in securities investment business, etc.") (Article 3(iii), Article 4(1), Article 24(1), etc.).

3. Second, under regulations on conducting business, the following activities have been added to the scope of Financial Instruments Business.

(1) Self-offering of interests in collective investment schemes (solicitation by the issuer itself of an application for the acquisition of such interests, including both through public offering and private placement) (Article 2(8)(vii)(f)). This activity falls under the definition of Type II Financial Instruments Business (Article 28(2)(i)).

(2) Management of investment (self-management) mainly in securities or Derivative Transactions in the form of a collective investment scheme (Article 2(8)(xv)(c)). This activity falls under the definition of Investment Management Business (Article 28(4)(iii)).

Therefore, in order to conduct the above activities in the course of trade or as a business, not to mention the business of dealing in public offering or secondary distribution or dealing in private placement of interests in collective investment schemes (Article 2(8)(ix)), it is necessary to obtain registration as Financial Instruments Business Operators or registered financial institutions, in principle (Articles 29 and 33-2).

4. Third, various regulations on activities are applied to Financial Instruments Business Operators, etc. which conduct these activities (Articles 34 through 45).
5. However, with regard to regulations on conducting business related to collective investment schemes, care is taken to avoid excessive regulation that could impede financial innovation based on the premise of protecting investors, thereby ensuring regulatory flexibility. To be more specific, business operations related to self-offering (private placement) of interests in collective investment schemes and Investment Management Business (self-management) involving such interests, if conducted only with professional investors (such as qualified institutional investors, etc.) as counterparties, are regarded as "Specially Permitted Businesses for Qualified Institutional Investors, etc." and therefore they are exempted from the obligation for registration. Meanwhile, with regard to these businesses, notification is required in order to grasp the actual circumstances of business, and a simple set of regulations on activities, etc. is applied (Articles 63 through 63-4).

6. Fourth, regulations concerning various unfair transactions (Chapter VI) are applied to transactions involving interests in collective investment schemes as well. Under the FIEA, when partnerships, etc. own 10% or more of the voting rights of listed companies, etc. as property of the partnerships, etc., they are subject to the obligation for the submission of trading reports and for the provision of profits arising from sales and purchases conducted in the short term (Article 165-2).

Q. What kinds of rights are excluded from interests in collective investment schemes?
A1. While providing a comprehensive definition regarding interests in collective investment schemes, the FIEA excludes categories of rights that are considered to have little need to achieve investor protection by regulating them under the FIEA from said definition under law, thereby clarifying the scope of application of the FIEA (Article 2(2)(v) of the FIEA).

2. Specifically, the following rights are excluded from application of the FIEA (Article 2(2)(v)(a) through (d)):
   (1) rights where all of the equity investors participate in the invested business and where there is little need to protect the equity investors as investors;
   (2) rights where the equity investors will not receive dividend of profits or distribution of the assets of the invested business in an amount exceeding the amount invested or contributed by them and where no investment nature is found;
   (3) rights where the equity investors are protected under other Acts (Insurance Business Act, the Agricultural Cooperatives Act, the Small and Medium-Sized Enterprise Cooperatives Act, the Real Estate Specified Joint Enterprise Act, etc.) that apply mutatis mutandis the regulations on activities under the FIEA;
   (4) rights that are found not to hinder the public interest or protection of equity investors because the necessary regulatory or supervising system is provided for under another Act or for other reasons.

3. Rights indicated on the securities listed in the items of Article 2(1) of the FIEA and rights that are deemed as securities pursuant to Article 2(2) of the FIEA (excluding interests in collective investment schemes) are excluded from the definition of interests in collective investment schemes.
(Article 2(2)(v)). Accordingly, rights that are individually listed in Article 2(1) and (2), such as shares and membership rights of an incorporated association, are not categorized as interests in collective investment schemes.

Q. What are the cases where all of the equity investors participate in the invested business, which are excluded from the definition of interests in collective investment schemes?

A1. "Cases where all of the equity investors participate in the invested business" (Article 2(2)(v)(a) of the FIEA), which are excluded from the definition of interests in collective investment schemes, need to satisfy all of the following requirements (Article 1-3-2 of the FIEA Enforcement Order):

(1) the business execution of the invested business is conducted with the consent of all of the equity investors (including the case where there is an agreement on not requiring the consent of all of the equity investors but business execution is conducted after all of the equity investors manifest their intentions on whether or not to give consent on the decision of the business execution); and

(2) all of the equity investors satisfy either of the following requirements:
   (i) to be regularly engaged in the invested business; or
   (ii) to be engaged in the invested business while demonstrating a particularly specialized ability that is indispensable for the continuance of the invested business.

Q. What other rights are excluded from the definition of interests in collective investment schemes?

A1. The FIEA specifies the following rights as rights that are "found not to hinder the public interest or protection of equity investors" to be excluded from the definition of interests in collective investment schemes (Article 2(2)(v)(d) of the FIEA):

(1) rights based on insurance or mutual aid contracts (those that are not subject to the Insurance Business Act) (Article 1-3-3(i) of the FIEA Enforcement Order);

(2) rights pertaining to investments in or contributions to juridical persons (excluding general incorporated associations other than public interest incorporated associations and general incorporated foundations other than public interest incorporated foundations) (Article 1-3-3(ii) of the FIEA Enforcement Order);

(3) rights based on shared forest contracts (Article 1-3-3(iii) of the FIEA Enforcement Order);

(4) rights based on partnership contracts, etc. where the invested business is the business of an attorney-at-law, certified public accountant, certified public tax accountant, etc. (Article 1-3-3(iv) of the FIEA Enforcement Order); and

(5) rights pertaining to an employee shareholding association, expanded employee shareholding association, or client shareholding association (Article 1-3-3(v) and (vi) of the FIEA Enforcement Order; Articles 6 and 7 of the Definition Ordinance).

2. Rights based on insurance or mutual aid contracts (those that are not subject to the Insurance Business Act) ((1) above) are excluded from the definition of interests in collective investment schemes, given that rights subject to the Insurance Business Act are excluded (Article 2(2)(v)(c) of
3. Rights pertaining to investments in or contributions to juridical persons (excluding general incorporated associations other than public interest incorporated associations and general incorporated foundations other than public interest incorporated foundations) ((2) above) are excluded from the definition of interests in collective investment schemes, because given that provisions on supervision by administrative organs are stipulated under laws and regulations for juridical persons, there is no need to make them subject to regulations under the FIEA in an overlapped manner. However, since there are no provisions on supervision by administrative organs for general incorporated associations other than public interest incorporated associations and general incorporated foundations other than public interest incorporated foundations, rights pertaining to investments in or contributions to such associations or foundations are not excluded from the definition of interests in collective investment schemes. Nevertheless, there are cases where, upon contribution of funds to a general incorporated association other than a public interest incorporated association or a general incorporated foundation other than a public interest incorporated foundation, an arrangement is made by articles of incorporation, etc. so that residual assets in an amount exceeding the amount of the fund contributed will not be distributed to the fund contributor and such arrangement is actually observed, and as a result of this, rights pertaining to such contribution fall under Article 2(v)(b) of the FIEA and are excluded from interests in collective investment schemes.

4. Rights based on shared forest contracts ((3) above) are excluded from the definition of interests in collective investment schemes, because provisions on supervision by prefectural governors are stipulated under the Act on Special Measures concerning Shared Forest.

5. Rights based on partnership contracts, etc. where the invested business is solely the business of an attorney-at-law, certified public accountant, certified public tax accountant, etc. ((4) above) are excluded from the definition of interests in collective investment schemes, because laws and regulations obligate certified public accountants, attorneys-at-law, certified public tax accountants, etc. to observe the articles of association of the organization to which they must become a member (institute of certified public accountants, bar association, certified public tax accountants' association, etc.) and are under the supervision of said organization.

6. Rights pertaining to an employee shareholding association or expanded employee shareholding association ((5) above) are excluded from the definition of interests in collective investment schemes, as was the case under the former Securities and Exchange Act and relevant regulations, because an employee shareholding association or expanded employee shareholding association purchases share certificates based on a specific plan instead of individual investment decisions and the business executor has little discretional power on the matter, and because there is a social condition that such association contributes to the welfare of employees, etc. Rights pertaining to a client shareholding association ((5) above) are also excluded from the definition of interests in
collective investment schemes under certain requirements, because a client shareholding association has a nature similar to that of employee shareholding associations and expanded employee shareholding associations.

**Derivative Transactions**

Q. What is the definition of "Derivative Transactions" under the FIEA?

A1. Under the FIEA, "Derivative Transactions" is a collective term for "market transactions of derivatives," "over-the-counter transactions of derivatives," and "foreign market derivatives transactions" (Article 2(20) of the FIEA).

1. "Market transactions of derivatives" are a certain type of Derivative Transactions conducted in a financial instruments market, in accordance with requirements and by using methods prescribed by the operator of the financial instruments market (Article 2(21) of the FIEA).

2. "Over-the-counter transactions of derivatives" are a certain type of Derivative Transactions conducted in neither a financial instruments market nor a foreign financial instruments market (Article 2(22) of the FIEA).

3. "Foreign market derivatives transactions" are transactions which are conducted in a foreign financial instruments market and are similar to market transactions of derivatives (Article 2(23) of the FIEA).

2. "Derivative Transactions" are basically divided into the following transaction types: (1) a type of transactions where assets subject to spot transactions are used as "underlying assets"; (2) a type of transactions where numerical values, which are not subject to spot transactions themselves, are used as "reference indicators"; and (3) any other type of transactions. Specifically, the FIEA provides for the following. The types of transactions can be additionally designated by Cabinet Order (Article 2(21)(vi) and Article 2(22)(vii)).

- As type (1): futures transactions / forward transactions (Article 2(21)(i), Article 2(22)(i)), option transactions (Article 2(21)(iii), Article 2(22)(iii)).
- As type (2): index futures transactions / index forward transactions (Article 2(21)(ii), Article 2(22)(ii)), option transactions (Article 2(21)(iii), Article 2(22)(iii)), index option transactions (the portion in parentheses in Article 2(21)(iii)(b), Article 2(22)(iv)), swap transactions (Article 2(21)(iv), Article 2(22)(v)), commodity swap transactions (Article 2(21)(iv)-2).
- As type (3): credit Derivative Transactions (Article 2(21)(v), Article 2(22)(vi)).

3. With regard to underlying assets of Derivative Transactions ("financial instruments"), the FIEA provides for securities, deposit claims, etc., currencies, and commodities, and "assets for which there are many of the same kind, [and] which have substantial price volatility" may be designated by Cabinet Order (Article 2(24)).

4. With regard to reference indicators of "Derivative Transactions" ("financial indicators"), the FIEA provides for prices or interest rates of financial instruments, and meteorological observation figures,
and indicators where it is impossible or extremely difficult for a person to exert his/her influence on the fluctuation thereof and which may have material impact on business activities of business operators or "statistical figures pertaining to social or economic conditions" may be designated by Cabinet Order (Article 2(25)).

5. As above, the FIEA constitutes the definition of "Derivative Transactions" based on transaction types and underlying assets/reference indicators, and allows for expansion of the scope and designation by Cabinet Order of both the transaction types and underlying assets/reference indicators, from the viewpoint of filling regulatory "gaps."

Q. What is the relationship between "Derivative Transactions" and “Securities”?

A1. Both "Derivative Transactions" and “Securities” are regulated under the FIEA as financial instruments/transactions with an investment character. However, since “Securities” are instruments that indicate rights whereas "Derivative Transactions" are acts, their positioning under the FIEA differs from each other. In the case of “Securities” certain acts conducted in relation to such securities (sales and purchases, etc.) are subject to the regulations on conducting business or the regulations on activities under the FIEA, but in the case of "Derivative Transactions," the act of such transaction itself is subject to the regulations on conducting business or the regulations on activities.

2. In addition, while “Securities” are subject to the disclosure regulation under the FIEA since they contribute to the investment decisions of investors, "Derivative Transactions" are not subject to the disclosure regulation. The provision of information on "Derivative Transactions" to investors is ensured through the regulations on activities relating to sales and solicitation (obligation to deliver a document, etc.).

(Note) However, among rights based on "Derivative Transactions," so-called covered warrants for which certificates are issued (Article 2(1)(xix) of the FIEA) are treated as securities and are subject to the disclosure regulation.

Q. Is a person registered for Financial Instruments Business eligible to conduct both so-called securities derivative transactions and financial futures transactions?

A1. From the viewpoint of developing more comprehensive regulations, the FIEA has consolidated the various business operations that had conventionally been regulated by the individual laws governing the respective types of business into "Financial Instruments Business" (Article 2(8) of the FIEA), and has consolidated and simplified the registration procedures. As part of this measure, securities derivative transactions, which had conventionally been regulated under the Securities and Exchange Act, and financial futures transactions, which had been regulated under the Financial Futures Trading Act, were categorized as "Derivative Transactions" (Article 2(20) of the FIEA) and included within the scope of Financial Instruments Business (Article 2(8)(i) through (iv) of the FIEA).

2. Meanwhile, from the viewpoint of ensuring regulatory flexibility, the FIEA provides for the
following categorization of the specific types of Derivative Transactions:

(1) market transactions of derivatives and foreign market derivatives transactions pertaining to highly liquid securities ("paragraph (1) securities") and over-the-counter transaction of derivatives are categorized as "Type I Financial Instruments Business" with strict market entry requirements (requirements for registration refusal) (Article 28(1)(i) and (ii) of the FIEA); and (2) market transactions of derivatives and foreign market derivatives transactions pertaining to less liquid securities ("paragraph (2) securities") and financial instruments other than securities are categorized as "Type II Financial Instruments Business" with relatively simplified market entry requirements (requirements for registration refusal) (Article 28(2)(ii) and (iii) of the FIEA).

(Note) However, such Derivative Transactions that involve receipt of a security deposit from the customer are deemed as "securities, etc. management business" (Article 2(8)(xvi) of the FIEA) and are categorized as "Type I Financial Instruments Business" (Article 28(1)(v) of the FIEA).

Financial Instruments Business

Q. What is the definition of "Financial Instruments Business" under the FIEA?

A1. The FIEA has expanded the scope of business operations subject to regulations, from the viewpoint of reviewing the conventional individual laws governing the respective types of business and simplifying the regulations (developing cross-sectoral regulations) and in line with the expansion (consolidation) of the subject commodities and transactions.

2. Accordingly, the FIEA defines the regulated business as "Financial Instruments Business" (Article 2(8) of the FIEA). The fundamental business operations of "Financial Instruments Business" are "sales and solicitation," "asset investment and advice," and "asset management" (Report of the First Subcommittee).

3. In addition, the following acts are also treated as "Financial Instruments Business": solicitation by the issuer of an application for the acquisition of its newly issued securities (so-called self-offering) (Article 2(8)(vii) of the FIEA); agency or intermediary services for conclusion of investment advisory contracts or discretionary investment contracts (Article 2(8)(xiii) of the FIEA); formation of collective investment schemes, etc. and investment of funds mainly in rights pertaining to securities or Derivative Transactions (so-called self-management)(Article 2(8)(xv) of the FIEA); acceptance of deposits of money or securities from the customer with regard to securities transactions, etc. (Article 2(8)(xvi) of the FIEA); and transfer of corporate bonds, etc. conducted in response to opening of an account for transfer of corporate bonds, etc. (Article 2(8)(xvii) of the FIEA).

Q. Are so-called self-offering and self-management covered by "Financial Instruments Business"?

A1. The FIEA prescribes "public offering or private placement of securities" as an act categorized as Financial Instruments Business (Article 2(8)(vii) of the FIEA), and provides that an act of
conducting self-offering (sales or solicitation by the issuer itself) on a regular basis is categorized as Financial Instruments Business. "Public offering or private placement" refers to the case where the issuer of securities practically conducts solicitation for an application for the acquisition of its newly issued securities ("solicitation for acquisition") (see Article 2(3) of the FIEA). The types of securities subject to the "public offering or private placement" which is categorized as "Financial Instruments Business" are limited to beneficiary certificates of investment trusts pertaining to beneficial interest of trust for investment based on settlor's instruction, beneficiary certificates of foreign investment trusts, mortgage securities, interests in collective investment schemes, and interests in commodity funds (trust type) (Article 2(8)(vii) of the FIEA; Article 1-9-2 of the FIEA Enforcement Order), in consideration of the need for investor protection and the convenience of fund procurement by the issuer.

2. The FIEA prescribes an act of investing money or other properties contributed from a person who holds interests in collective investment schemes, trust beneficial interests, or beneficiary securities of beneficiary securities issuing trusts mainly as an investment in securities or rights pertaining to Derivative Transactions conducted under investment decisions based on analysis of values, etc. of financial instruments, as an act categorized as Financial Instruments Business (Article 2(8)(xv) of the FIEA). In addition, the FIEA prescribes that an act of forming collective investment schemes, etc. and investing funds mainly as an investment in securities or Derivative Transactions (so-called self-management) is categorized as Financial Instruments Business. An act of self-management is categorized as "Investment Management Business" under the FIEA only when funds are invested mainly as an investment in securities or rights pertaining to Derivative Transactions. An act of forming collective investment schemes, etc. and investing funds mainly as an investment in any other property, such as real estate, etc. is not categorized as "Financial Instruments Business" even if it is conducted on a regular basis.

3 A person who intends to conduct self-offering or self-management on a regular basis needs to be registered. However, when such act falls under the category of specially permitted business for qualified institutional investor, etc. (so-called funds for professional investors) pertaining to interests in collective investment schemes, no registration is required, and notification suffices (Article 63(1) and (2) of the FIEA). Also, when a juridical corporation conducting Investment Management Business pertaining to collective investment schemes in a foreign state conducts Investment Management Business pertaining to collective investment schemes in Japan only with Financial Instruments Business Operators or a registered financial institution engaged in Investment Management Business as counterparties, no registration or notification is required (Article 61(3) of the FIEA; Article 17-11(1) of the FIEA Enforcement Order).

Q. Is the FIEA applied to acts that are excluded from "Financial Instruments Business"?

A1. Whether or not the provisions of the FIEA apply to acts that are excluded from the definition of "Financial Instruments Business" should be determined in light of the purport of the respective
provisions and other factors.

2. Basically, such acts are not directly subject to regulations on conducting business or regulations on activities (the obligation to deliver a document prior to and at the time of the conclusion of a contract, the obligation to prepare and deliver investment reports, etc.), and nor are they directly subject to the obligation of preparation and preservation of books and documents. For example, registration of sales representatives is presumed to be unnecessary for over-the-counter transactions of non-securities-related derivatives, etc. conducted with professional investors as counterparties (Article 1-8-6(1)(ii) of the FIEA Enforcement Order), which are excluded from Financial Instruments Business.

3. The FIEA limits the type of actors for some of the acts that are excluded from the definition of "Financial Instruments Business," and in such cases, only acts conducted by such actors are excluded. Thus, it is not possible to uniformly conclude that Financial Instruments Business Operators are eligible to conduct all of such acts. However, it is presumed that business operations that satisfy the requirements under individual provisions can basically be conducted as "incidental business" of Financial Instruments Business Operators (persons who conduct Type I Financial Instruments Business or Investment Management Business) (the principal sentence of Article 35(1) of the FIEA), and that such acts can be conducted without making notification of subsidiary business (Article 35(3) of the FIEA) or receiving approval for subsidiary business (Article 35(4) of the FIEA). Nevertheless, the general provisions on supervision under Article 51 of the FIEA are considered to apply to such business operations as well, so such business operations may become subject to the order to improve business operations under Article 51 of the FIEA or other measures.

4. Also when banks, etc. conduct acts that are excluded from the definition of "Financial Instruments Business," the registration to become a registered financial institution (Article 33-2 of the FIEA) is considered to be unnecessary, unless where the FIEA excludes financial institutions from the actors of those acts.

<table>
<thead>
<tr>
<th>Q. What is the scope of professional investors who are counterparties of over-the-counter transactions of derivatives, etc. that are excluded from &quot;Financial Instruments Business&quot;?</th>
</tr>
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</table>
| A1. The FIEA excludes over-the-counter transactions of non-securities-related derivatives, etc. that are conducted with persons specified by Cabinet Ordinance as those who are found to have expert knowledge of and experience with Derivative Transactions, or stock companies with a capital amount not less than the amount specified by Cabinet Ordinance as counterparties, from the definition of "Financial Instruments Business" (Article 1-8-6(1)(ii) of the FIEA Enforcement Order).

2. However, in accordance with the purport of the FIEA to ensure investor protection, the FIEA limits the scope of acts excluded from the definition of "Financial Instruments Business" to those that are truly found not to hinder investor protection. To be more specific, the FIEA excludes acts from the definition of "Financial Instruments Business" only when the counterparties are Financial |
Instruments Business Operators (limited to those engaged in Type I Financial Instruments Business), registered financial institutions, qualified institutional investors, etc., stock companies with a capital amount of not less than one billion yen, or specific purpose companies, etc. with a specified capital amount of not less than one billion yen (Article 15 of the Definition Ordinance; Public Notice of the Financial Services Agency No. 53 of 2007).

According to this, if a bank, etc. which is a registered financial institution conducts over-the-counter interest rate swap transactions, etc. with a small and medium-sized company with a capital amount of less than one billion yen as the counterparty, such act is subject to regulations under the FIEA.

Q. What kinds of acts pertaining to interests in collective investment schemes are excluded from "Financial Instruments Business"?

A1. The FIEA treats "public offering or private placement" (so-called self-offering) of interests in collective investment schemes as Financial Instruments Business (Article 2(8)(vii)(f) of the FIEA), and regulates such act as "Type II Financial Instruments Business" (Article 28(2)(i) of the FIEA). When the issuer of interests in collective investment schemes entrusts the solicitation for acquisition of said interests to an external third party and does not directly engage in the act of solicitation, the issuer does not need to make registration or notification concerning the self-offering, since the issuer is not conducting the "public offering or private placement."

2. Also, the FIEA treats business operations of investing money, etc. contributed from a person who holds interests in collective investment schemes mainly as an investment in securities or Derivative Transactions (so-called self-management) as Financial Instruments Business (Article 2(8)(xv)(c) of the FIEA), and regulates such operations as Investment Management Business (Article 28(4)(iii) of the FIEA).

3. However, the FIEA excludes acts which are formally categorized as self-management but which fall under the following cases from the definition of Financial Instruments Business (Article 2(8)(xv) of the FIEA) because they are considered to have little need to be regulated as Investment Management Business (the principal sentence of Article 2(8) of the FIEA).

(1) The first case is self-management conducted as contribution of the entire amount of capital to a single juridical person in a two-tier commodity fund scheme (Article 1-8-6(1)(iii) and Article 1-8-6(2) of the FIEA Enforcement Order). In this case, contribution is made to a single juridical person by using all of the money, etc. contributed from a person who holds beneficial interests in commodity investment. Therefore, this case satisfies such requirements as the juridical person wholly entrusting a commodities investment advisor, etc. with investment decisions concerning commodity investment.

(2) The second case is self-management conducted in the case where all of the authority for investment with regard to a collective investment scheme has been entrusted to another person (Article 1-8-6(1)(iv) of the FIEA Enforcement Order; Article 16(1)(x) of the Definition
Ordinance). In this case, a person has entrusted all of the authority for investment. Therefore, this case satisfies such requirements as conclusion of a discretionary investment contract with a Financial Instruments Business operator, etc. (registered business operator), and it is a case where such Financial Instruments Business operator, etc. has made notification of the required matters concerning said person in advance.

(3) The third case is self-management of a baby fund of a two-tiered real estate fund (Article 16(1)(xi) of the Definition Ordinance). This is a case where money, etc. contributed based on an anonymous partnership agreement concluded with a single counterparty (a Financial Instruments Business operator, etc. who is a business operator of another anonymous partnership (a person who conducts Investment Management Business), a specially permitted business notifying person, or a person who conducts special Investment Management Business (Article 48(1) of the Supplementary Provisions of the Act for Partial Revision of the Financial Instruments and Exchange Act (hereinafter referred to as the "Revising Act")) is invested in beneficial interests of real estate trust. It is a case where the counterparty (a business operator of the mother fund) has made notification of the required matters concerning said person (a business operator of baby fund) in advance.

(4) The fourth case is self-management in a race horse fund scheme (Article 16(1)(xii) of the Definition Ordinance). This is a case where a person conducting "race horse investment related business operations" (Article 7(iv)(d) of the Cabinet Office Ordinance on Financial Instruments Business, etc. (hereinafter referred to as the "Financial Instruments Business Ordinance")) (such business operations refer to sales or solicitation operations pertaining to rights based on anonymous partnership agreements (those intended for acquiring race horses by using all of the money that has been contributed, and providing those race horses as contribution in kind to a business operator of another anonymous partnership, etc.)) (such person is a so-called horse-lovers corporation) makes the equity interest in said other anonymous partnership (a so-called club corporation) the investment target.

(5) The fifth case is self-management of a foreign collective investment scheme (Article 16(1)(xiii) of the Definition Ordinance). This is a case that satisfies such requirements as the act being conducted by a qualified institutional investor or specially permitted business notifying person where less than 10 equity investors of the foreign collective investment scheme are residents in Japan, and the amount of contribution by the residents in Japan is not more than one-third of the total amount of contribution.

4. Furthermore, the following acts of underwriting pertaining to interests in collective investment schemes are excluded from the definition of "Financial Instruments Business" (Article 2(8)(vi) of the FIEA) since there is little need to protect investors by treating such acts as "underwriting" (the principal sentence of Article 2(8) of the FIEA):

(1) First is the act of underwriting pertaining to a lease business (Article 1-8-6(1)(iv) of the FIEA Enforcement Order; Article 16(1)(v) of the Definition Ordinance). This is a case where a
Financial Instruments Business operator (limited to a juridical person conducting Type II Financial Instruments Business, with a stated capital, etc. of 50 million yen or more) underwrites rights based on an anonymous partnership agreement from a wholly owned subsidiary (stock company) conducting a lease business.

(2) Second is the act of underwriting pertaining to the formation of a two-tiered real estate fund (Article 16(1)(vi) of the Definition Ordinance). This is a case where a Financial Instruments Business operator (limited to a juridical person conducting Type II Financial Instruments Business) underwrites equity interests in an anonymous partnership of a real estate private placement fund (corresponding to a so-called baby fund) for the purpose of having a business operator of another anonymous partnership (corresponding to a so-called mother fund) acquire those equity interests.
Section 3 Disclosure of corporate affairs and other related matters

Internal control over financial reporting

Q. Why was the Internal Control Report system introduced?

A1. In order for the securities market to fully demonstrate its functions, it is indispensable that corporate information is properly disclosed to investors. However, incidents of inappropriate corporate financial disclosure have occurred in succession recently. It has been pointed out that companies' internal control over financial reporting may not have been functioning effectively in such incidents. Enhancement of internal control over financial reporting is an important task for ensuring proper disclosure.

2. From such viewpoint, the FIEA introduced the Internal Control Report system as a measure to enhance internal control over financial reporting (Article 24-4-4 and Article 193-2(2) of the FIEA). The Internal Control Report system obligates listed companies, etc. to ensure that assessment by the management and audit by a certified public accountant or an audit firm are conducted with regard to the effectiveness of the internal control over financial reporting.

Q. What are the details of the Internal Control Report system, and from when is it applied?

A1. Cabinet Order provides that listed companies (see Article 24(1)(i) of the FIEA) are basically the entities subject to the Internal Control Report system (Article 24-4-4(1) of the FIEA; Article 4-2-7(1) of the FIEA Enforcement Order).

2. As for the matters to be disclosed under the Internal Control Report system, an Internal Control Report containing the results of assessment of the system necessary for ensuring appropriateness of documents on finance and accounting and other information (prepared on a consolidated basis) is to be submitted together with the annual securities report (Article 24-4-4(1) of the FIEA). The matters to be stated in the Internal Control Report are specified by Cabinet Office Ordinance. Specifically, they are as follows: (1) matters concerning the basic framework of the internal control over financial reporting; (2) matters concerning the scope, reference date, and procedure of the assessment; (3) matters concerning the assessment results; and (4) supplementary matters (Article 24-4-4(1) of the FIEA; Article 4 and the item (i) form of the Cabinet Office Ordinance on the System for Ensuring Appropriateness of Documents on Finance Calculation and Other Information (hereinafter referred to as the "Internal Control Ordinance").

3. The Internal Control Report is required to undergo an audit process (internal control audit) by a certified public accountant or an audit firm and receive the certification (Article 193-2(2) of the FIEA).

4. The Internal Control Report and other disclosure documents are to be made available for public inspection for five years from the date of their submission (Article 25(1)(vi) of the FIEA).

(the date of enforcement of the FIEA), and have been applied to business years starting on or after April 1, 2008 (Article 15 of the Supplementary Provisions of the Revising Act).

Q. What is the scope of companies that are obligated to submit an Internal Control Report?

A1. Since the purpose of introduction of the Internal Control Report system is to ensure proper disclosure of corporate information to investors, it is appropriate to apply the system basically to companies listed on highly liquid secondary markets where a broad range of investors are to invest. Accordingly, the target companies are to be companies whose securities, such as share certificates and preferred equity securities, are listed and traded on securities markets or over-the-counter markets (including cooperative structured financial institutions) (Article 24-4-4(1) of the FIEA; Article 4-2-7(1) of the FIEA Enforcement Order).

2. A company submitting an annual securities report (excluding such report pertaining to a certain type of securities) may submit an Internal Control Report voluntarily, even if it is not a listed company, etc. (Article 24-4-4(2) of the FIEA).

Q. Are foreign companies also obligated to submit an Internal Control Report?

A1. If a foreign company is a listed company, etc. in Japan, it is obligated to submit an Internal Control Report and documents to be attached thereto, as in the case of a Japanese company (Article 24-4-4(1) and (4) of the FIEA; Article 4-2-7(1)(iii) through (v) of the FIEA Enforcement Order).

2. In certain cases, such as where the Commissioner of the Financial Services Agency gives approval, a foreign company may submit a report assessing the internal control over financial reporting that has been disclosed in its home country, etc. as the Internal Control Report (Article 24-4-4(1) of the FIEA; Article 11 of the Internal Control Ordinance).

3. In certain cases, a foreign company submitting an annual securities report in Japan may submit documents stating the matters to be stated in an Internal Control Report, etc. which are prepared in English, in lieu of an Internal Control Report and other related documents prepared in Japanese (Article 24-4-4(6) of the FIEA). In order to implement this provision, required revisions will be made to relevant Cabinet Orders and Cabinet Office Ordinances in around spring of 2008.

Q. What are the standards for assessment and audit of the internal control over financial reporting?

A1. The FIEA and regulations provide that, when preparing an Internal Control Report and an internal control audit report (a report on audit certification of the Internal Control Report), matters not specified by Cabinet Office Ordinance should be stated in accordance with the "generally accepted assessment standards for the internal control over financial reporting" and the "generally accepted audit standards and practices for the internal control over financial reporting" (Article 24-4-4(1) and Article 193-2(2) of the FIEA; Article 1(1) and (3) of the Internal Control Ordinance).

2. The standards and the practice standards published by the Business Accounting Council are regarded as generally accepted assessment and audit standards for the internal control (Article 1(4)
of the Internal Control Ordinance).


5. The outline of the standards and practice standards for assessment and audit concerning internal control over financial reporting is as follows:

(1) Basic framework of internal control

Internal control is a process basically performed in order to provide reasonable assurance of achieving four objectives: (i) effectiveness and efficiency of business operations, (ii) reliability of financial reporting, (iii) compliance with applicable laws and regulations relevant to business activities, and (iv) safeguard of assets. Internal control consists of six basic components: (i) control environment, (ii) risk assessment and response, (iii) control activities, (iv) information and communication, (v) monitoring, and (vi) response to IT.

(2) Assessment and report on internal control over financial reporting

Management has the role and responsibility to design and operate internal control. It is particularly vital for management to assess the effectiveness of the internal control over financial reporting and report its conclusion externally. In evaluating the effectiveness of internal controls, management should first assess internal controls that have a material impact on overall consolidated financial reporting ("company-level controls") and, based on the results, assess the "operational process-level controls." Management is then to prepare an "Internal Control Report" and state the results of said assessment on the effectiveness of the internal controls over financial reporting, etc. (such as "effective" or "not effective due to the presence of material deficiencies that should be disclosed").

(3) Audit on internal control over financial reporting

The auditors audit the results of the management’s assessment of the effectiveness of internal control over financial reporting. They first examine the appropriateness of the scope of assessment as determined by the management, and then examine the management's assessment of company-level controls and the assessment of operational process-level controls performed by the management based on the result of assessments of company-level controls. The auditors prepare an “internal control audit report” and express their opinion ("unqualified opinion," "qualified opinion," or "adverse opinion") and other matters therein.
Q. What was the background behind the establishment of the standards and practice standards for assessment and audit concerning internal control over financial reporting?

A1. In order to ensure appropriate implementation of assessment of the effectiveness of internal control over financial reporting and audit by a certified public accountant or an audit firm in practice, it is necessary to formulate assessment/audit standards and practical guidance.

2. From such viewpoint, the Internal Control Committee (chair: Shinji Hatta, professor, Aoyama Gakuin University) of the Business Accounting Council studied the details of internal control practices in Japanese companies as well as internal control standards in the United States and other countries, and made deliberations. On December 8, 2005, the committee compiled "Draft Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting." At that time, many comments were offered requesting development of a set of practical guidance (practice standards) which will assist in application of the standards to actual practice. Therefore, a task force was set up within the committee, and discussions were held on draft practice standards.

3. Following such discussions, on February 15, 2007, the Business Accounting Council (chair: Hideyoshi Ando, professor, Hitotsubashi University) finally published "About the Setting of the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting (Council’ Opinion)."

Q. What points should be kept in mind when operating the standards and practice standards for assessment and audit concerning internal control over financial reporting?

A1. Ensuring proper disclosure is primarily the responsibility of management, and management has the role and responsibility to design and operate internal control. From such viewpoint, a design and operation of internal control should not be uniform, but should vary by company, in accordance with the environment surrounding the company, the characteristics of its business, its size, etc. Management is expected to undertake appropriate efforts to effectively fulfill the functions and the roles of internal controls in accordance with the specific circumstances of the company.

2. In designing the Internal Control Report system, the important point of how the system should be efficiently operated while securing its effectiveness was discussed. Therefore, with regard to operation of the standards and practice standards, very specific guidelines are indicated for the development, assessment, and audit of internal control over financial reporting, including indication of numerical examples (such as the guideline for determining a "material deficiency that should be disclosed" (around 5% of consolidated pretax profit)), while taking into account the opinions of people who are actually engaged in such assessment or audit and maintaining the basic idea of respecting the original efforts of the individual companies.

3. Meanwhile, the following points need to be kept in mind upon operation of the standards and practice standards:

(1) the basic idea indicated in the standards and practice standards should be observed sufficiently, and the standards and practice standards should not be applied in a formal, uniform, or inflexible
manner deviating from the basic idea;

(2) since the standards and practice standards have been prepared to be commonly applied to all companies, how internal control should be designed and operated in accordance with the type of business and the company's characteristics should be determined based on the original efforts of the individual companies.

Q. What is the scope of "internal control over financial reporting"?

A1. The Internal Control Report system introduced by the FIEA requires assessment by management and audit by auditors with a specific focus on "internal control over financial reporting," from the viewpoint of ensuring proper disclosure. Therefore, if the internal control system developed by a company also covers processes other than financial reporting, the part of the system irrelevant to financial reporting is not subject to the assessment and audit.

2. "Financial reporting" is external reporting of both 1) financial statements and 2) disclosure information and others that could have a material effect on the reliability of financial statements. "Internal control over financial reporting" is the system to ensure that financial reporting in a company is properly prepared according to laws and regulations (Article 24-4-4(1) of the FIEA; Article 2(i) and (ii) of the Internal Control Ordinance).

3 The practice standards specifically indicate the scope of financial statements and disclosure information and others that could have a material effect on the reliability of financial statements. Other than financial statements, the following are mentioned as matters covered by the scope: (1) disclosure information to be provided as a summary, excerpt, or breakdown of the values presented in the financial statements; and (2) matters that are closely related to the decision of whether an entity is an affiliate, decision on the scope of consolidation, and other decisions involved in preparing the financial statements.

Q. How does the Japanese Internal Control Report system differ from the Internal Control Report system pertaining to financial reporting that was introduced in the United States by the Sarbanes–Oxley Act of 2002?

A1. The U.S. Internal Control Report system under Section 404 of the Sarbanes–Oxley Act of 2002 (SOX) requires that the companies registered with the U.S. Securities and Exchange Commission (SEC) include an Internal Control Report stating the results of assessment of the effectiveness of internal control over financial reporting in the annual report, and that such Internal Control Report undergo audit by an auditor. It is presumed that there is hardly any difference in the basic framework of the Japanese and U.S. systems.

2. In the United States, the Internal Control Report system has been acclaimed to contribute to raising the awareness of the management, enhancing investors' confidence in financial reporting, and increasing the efficiency of companies' business operations. At the same time, however, it has been pointed out that the cost of assessment and audit is swelling, and is affecting the international
competitiveness of the U.S. capital market. Accordingly, in June 2007, the U.S. SEC newly formulated and put into effect guidance on management assessment, and in July 2007, the Public Company Accounting Oversight Board (PCAOB) reviewed the system, including revision of the audit standards.

3. Due to such circumstances, when the Business Accounting Council developed the standards and practice standards, it verified the status of operation of the system that was already being introduced in the United States, and incorporated the following measures so as to prevent an excessive cost burden:

1. Using top-down/risk-based approach
   Operational process-level controls are assessed based on the assessment of the results of company-level controls (internal controls that have a material impact on overall consolidated financial reporting), focusing on the risks that could create material misstatements.

2. Simplifying classification of deficiencies of internal controls
   Classification of deficiencies in internal control was simplified into two categories: "material deficiencies that should be disclosed" and "deficiencies" (the deficiencies are classified into three categories in the United States: "material weakness," "significant deficiencies," and "deficiencies").

3. Not adopting direct reporting
   Audit is conducted only on assessment of the internal control that has been conducted by management. The direct reporting, which was adopted in parallel with the audit of management’s assessment in the United States at first and where auditors directly assess the internal control (audit irrelevant to management’s assessment), was not adopted in Japan. (Later, based on PCAOB’s new auditing standard (Auditing Standard No. 5; approved by SEC in July 2007), the United States abolished audit on management’s assessment of the internal control, and adopted direct reporting only.)

4. Integrated implementation of internal control audit and audit of financial statements
   Internal control audits are to be performed by the same auditors responsible for auditing the company's financial statements, in principle. Audit evidence obtained in an audit may be used in both audits. (In the United States, the two audits must be performed by the same audit firm, but not necessarily by the same auditors.)

5. Preparation of internal control audit report and financial statement audit report in a unified form
   The internal control audit report is, in principle, to be prepared in conjunction with the report of financial statements audit.

6. Coordination between auditors and audit committee / internal auditors
   Auditors are to appropriately coordinate with audit committee, etc. and, when necessary, make use of the work of internal auditors.
Q. Are there penal provisions against those who violate provisions of Internal Control Reports?

A. When a person submits an Internal Control Report including misstatement on important matters or fails to submit an Internal Control Report, the person is punished by imprisonment with work for not more than five years or by a fine of not more than five million yen, or both (in the case of an individual) or a fine of not more than 500 million yen (in the case of a juridical person) (Article 197-2(v) and (vi) and Article 207(1)(ii) of the FIEA).
Section 4 Financial Instruments Business Operators, etc.

Professional investors and general investors

Q. How are foreign investors treated?

A1. The professional investor system under the FIEA classifies customers eligible to be protected by way of regulation and applies regulation in accordance with the customer classes, thereby ensuring regulatory flexibility. Therefore, investors not eligible to be protected by way of regulation are not covered by the professional investor system in the first place.

2. As the FIEA is basically intended to protect residents in Japan, foreign investors who are non-residents are presumed to not necessarily be eligible for protection. However, foreign investors (non-residents) are presumed to be eligible for protection and to be covered by the professional investor system when Financial Instruments Business Operators, etc. sell products to them or solicit them as customers in Japan, for example.

3. When Financial Instruments Business Operators, etc. conduct transactions with foreign juridical persons in Japan, it is presumed to not always be necessary to apply various investor protection laws. In light of this as well as convenience, etc. for foreign investors (non-residents), foreign juridical persons among foreign investors (non-residents) are treated as "professional investors who may change their status to general investors as an option" (Article 2(31)(iv) of the FIEA; Article 23(x) of the Definition Ordinance).

4. On the other hand, individual foreign investors are treated in the same way as domestic individual investors. However, with regard to individuals who are managers of partnerships, etc. based on foreign laws and regulations, it is presumed to be difficult to check whether they meet the requirements for "professional investors who may change their status to general investors as an option" given the diverse types of partnerships, etc. based on foreign laws and regulations. Therefore, in order to facilitate the conduct of practical affairs and for other objectives, such individuals are not treated as "professional investors who may change their status to general investors as an option" (see Article 34-4(1)(i) of the FIEA; Article 61(2) of the Financial Instruments Business Ordinance). It should be noted that individuals who are managers of anonymous partnerships, those who are operating partners of partnerships as specified by the Civil Code, or those who are involved in decisions on the execution of important business operations of limited liability partnerships and execute them are treated as "professional investors who may change their status to general investors as an option" under certain conditions (Article 34-4(1)(i) of the FIEA; Article 61 of the Financial Instruments Businesses Ordinance).
### Foreign Business Operators

**Q. How are Foreign Business Operators treated?**

A1. When Foreign Business Operators conduct Financial Instruments Businesses as agents of residents in Japan or with them as counterparties, they are in principle required to be registered just as domestic business operators are (Article 29 of the FIEA).

2. However, in some cases, special treatment may be provided to Foreign Business Operators from the perspective of their special characteristics and the clarity of regulatory application.

3. First, Foreign Securities Brokers (Article 58 of the FIEA) do not need to be registered for Financial Instruments Business when the counterparties with which they conduct transactions are Financial Instruments Business Operators engaged in securities-related business, for example (the proviso to Article 58-2 of the FIEA).

4. Next, Foreign Securities Brokers are subject to the permission system when they conduct underwriting business or transaction-at-exchange operation (Articles 59 and 60 of the FIEA).

5. Foreign juridical persons and individuals domiciled in a foreign state who conduct investment advisory business in a foreign state do not need to be registered as Financial Instruments Business Operators when the counterparties with which they conduct the investment advisory business are limited to Financial Instruments Business Operators engaged in Investment Management Business, etc. (Article 61(1) of the FIEA). Foreign juridical persons who conduct Investment Management Business in a foreign state based on discretionary investment contracts do not need to be registered, either, when the counterparties with which they do so are limited to Financial Instruments Business Operators engaged in Investment Management Business, etc. (Article 61(2) of the FIEA).

6. In addition, while collective investment scheme-type Investment Management Business (so-called self-management) is treated as Financial Instruments Business under the FIEA (Article 2(8)(xv) of the FIEA), foreign juridical persons who conduct self-management business in a foreign state do not need to be registered, either, when the counterparties with which they do so are limited to Financial Instruments Business Operators engaged in Investment Management Business, etc. as in the case of the abovementioned exceptions related to Investment Management Business based on discretionary investment contracts (Article 61(3) of the FIEA).

**Q. In what kinds of cases is a Foreign Securities Broker exempted from the requirement to be registered?**

A1. In the following cases, Foreign Securities Brokers are permitted to conduct securities-related business without being registered (the proviso to Article 58-2 of the FIEA; Article 17-3 of the FIEA Enforcement Order):

(1) the case where a Foreign Securities Broker conducts acts from a foreign state with a person in Japan who is found to have sufficient knowledge and experience, such as a financial institution,
a trust company, or a Financial Instruments Business operator conducting Investment
Management Business, as the counterparty (Article 17-3(i) of the FIEA Enforcement Order;
Articles 209 through 212 of the Financial Instruments Business Ordinance);
(2) the case where a Foreign Securities Broker conducts acts from a foreign state, without soliciting
domestic customers, (i) by receiving orders from domestic customers, or (ii) through agency or
intermediary services of a Financial Instruments Business operator conducting securities-related
business (limited to a person registered as an operator of Type I Financial Instruments Business)
(Article 17-3(ii) of the FIEA Enforcement Order; Article 213 of the Financial Instruments
Business Ordinance); (note) and
(3) the case where a Foreign Securities Broker only holds discussion for fixing the contents of the
wholesale underwriting contract in Japan with the issuer or holder of the securities (excluding
the case where secondary distribution of securities or handling of public offering, private
placement, and secondary distribution is conducted in Japan) (Article 17-3(iii) of the FIEA
Enforcement Order; Article 214 of the Financial Instruments Business Ordinance).
(Note) In both of the cases in (i) and (ii) above, with regard to acts concerning over-the-counter transactions of
securities-related derivatives, the domestic customers to be counterparties are limited to Financial Instruments
Business Operators, etc., qualified institutional investors, and stock companies, etc. with a capital amount of
one billion or more (Article 17-3(ii)(a) and (b) and Article 1-8-6(1)(ii)(a) and (b) of the FIEA Enforcement
Order; Article 15(1) and (2) of the Definition Ordinance).
2. When a Foreign Securities Broker conducts underwriting business or transaction-at-exchange
operation, the broker does not need to be registered, but needs to obtain permission for such act
(Articles 59 and 60 of the FIEA).

Q. In what kinds of cases is a person Conducts Investment Advisory Business or Investment
Management Business in a foreign state exempted from the requirement to be registered?

A1. The FIEA does not require registration in the following cases:
(1) the case where a foreign juridical person or an individual domiciled in a foreign state who
conducts investment advisory business in a foreign state engages in investment advisory
business with only a domestic Financial Instruments Business operator or a domestic registered
financial institution conducting Investment Management Business as the counterparty (Article
61(1) of the FIEA; Article 17-11(1) of the FIEA Enforcement Order); and
(2) the case where a foreign juridical person conducting Investment Management Business based
on a discretionary investment contract (Article 2(8)(xii) of the FIEA) in a foreign state engages
in the Investment Management Business with only a domestic Financial Instruments Business
operator or a domestic registered financial institution conducting Investment Management
Business as the counterparty (Article 61(2) of the FIEA; Article 17-11(2) of the FIEA
Enforcement Order).
2. Also, while the FIEA treats Investment Management Business in the form of a collective investment
scheme (Article 2(8)(xv) of the FIEA) as a Financial Instruments Business, as in the case of Investment Management Business based on a discretionary investment contract, it requires neither registration nor notification in the following case:

(3) the case where a foreign juridical person conducting Investment Management Business in the form of a collective investment scheme in a foreign state engages in the Investment Management Business with only a domestic Financial Instruments Business operator or a domestic registered financial institution conducting Investment Management Business as the counterparty (Article 61(3) of the FIEA; Article 17-11(1) of the FIEA Enforcement Order).

3. Furthermore, the FIEA requires neither registration nor notification for a foreign fund operator conducting an act of investment management in the form of a collective investment scheme (Article 2(8)(xv) of the FIEA) who satisfies such requirements as follows: (1) the equity investors in Japan (direct equity investors/indirect equity investors) are limited to less than ten qualified institutional investors or specially permitted business notifying persons, and (2) the amount of contribution by these equity investors is not more than one-third of the foreign fund's total amount of contribution (the principal sentence of Article 2(8) of the FIEA; Article 1-8-3(1)(iv) of the FIEA Enforcement Order; Article 16(1)(xiii) of the Definition Ordinance).

Q. How is establishment of a representative office, etc. of a foreign business operator treated under the FIEA?

A1. Under the FIEA, when a Foreign Securities Broker, a person Conducts Investment Advisory Business in a foreign state (excluding a registered business operator in Japan), or a person conducting the same type of business as the business of a trust company in a foreign state intends to establish a representative office, etc. in Japan in order to collect and provide information of the securities market or the market of financial indicators pertaining to securities, such person must give notification of the contents of the business, the location of the facility, and other matters in advance (Article 62(1) of the FIEA; Article 233(1)(iii) of the Financial Instruments Business Ordinance). Also, an order to submit a report or materials concerning the business may be issued against such persons (Article 62(2) of the FIEA).

2. Moreover, the FIEA has similar provisions for a person conducting Investment Management Business in a foreign state (excluding a registered business operator in Japan). Since the business of forming collective investment schemes, etc. and investing funds mainly as an investment in rights pertaining to securities or Derivative Transactions (so-called self-management) is also included in the scope of Investment Management Business (Article 2(8)(xv) of the FIEA), the FIEA also applies the abovementioned provisions on the obligation of notification and the order to submit a report or materials to a person conducting the business of self-management in a foreign state (Article 62 of the FIEA).

3. In addition, the FIEA has similar provisions for a person conducting the business of self-offering (Article 2(8)(vii) of the FIEA), the business of receiving deposits of money or securities (excluding
the business of receiving deposits of money from customers in connection to business other than securities-related business) (Article 2(8)(xvi) of the FIEA), or the business of transfer of corporate bonds, etc. (Article 2(8)(xvii) of the FIEA) in a foreign state (Article 233(1)(i) and (ii) of the Financial Instruments Business Ordinance).

4. The matters to be included in the notification are as follows: (1) the contents of the business; (2) the location of the facility; (3) the trade name or name; (4) the location of the head office or principal office; (5) the contents of the business operations; (6) the amount of stated capital or the total amount of contribution; (7) the title and the name of the officer who has the authority of representation; (8) the name of the domestic facility, the name and address of the representative person in Japan, the reason for the establishment of the facility, the number of employees, and the planned date of establishment of the facility (Article 62(1) of the FIEA; Article 233(2) of the Financial Instruments Business Ordinance).