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NOTES AND COMMENTS

Reducing the United States Trade Imbalance with Japan: Equal Access for United States Securities Dealers

The way to resolve trade problems is to seek open, not closed, markets; to seek multilateral negotiation, not unilateral legislation.

Ronald Reagan¹

I. THE UNITED STATES-JAPAN TRADE IMBALANCE

The trade deficit between the United States and Japan, while recently decreasing, remains over \$52 billion.² This trade deficit accounts for a substantial amount of the total United States trade deficit, which in 1988 was \$119 billion.³ There are a number of reasons why the United States trade deficit with Japan remains at such a high level. The United States has claimed that this trade deficit is a result of both formal and informal Japanese barriers to trade, while the Japanese point to United States trade barriers, uncompetitive United States products, and complacent attitudes and inadequate efforts of United States industry to improve performance.⁴ However, the actual cause of the trade deficit appears to be the massive federal budget deficit of the United States.⁵ As the largest debtor nation in

1. President Reagan's News Conference Following the Tokyo Economic Summit, 22 WEEKLY COMP. PRES. DOC. 588, 589 (May 7, 1986).

2. U.S. Department of Commerce, Bureau of the Census, Foreign Trade Data Service (1989).

3. *Id.* For example, the total trade deficits for the United States since 1980 are as follows: 1988 - \$119 billion; 1987 - \$152 billion; 1986 - \$138 billion; 1985 - \$117 billion; 1984 - \$106 billion; 1983 - \$52 billion; 1982 - \$27 billion; 1981 - \$22 billion; 1980 - \$19 billion. By comparison, the United States trade deficits with Japan in those years were as follows: 1988 - \$52 billion; 1987 - \$56 billion; 1986 - \$55 billion; 1985 - \$46 billion; 1984 - \$33 billion; 1983 - \$19 billion; 1982 - \$16 billion; 1981 - \$15 billion; 1980 - \$10 billion. *Id.*

4. *United States-Japan Economic Relations: Hearing Before the Subcomm. on Int. Finance, Trade and Monetary Policy of the House Comm. on Banking, Finance, and Urban Affairs*, 100th Cong., 1st Sess. 64 (1987) [hereinafter *Economic Relations Hearing*] (statement of Allan I. Mendelowitz, Senior Associate Director, General Accounting Office).

5. *Id.* at 65. As a result of increased budget deficits, the federal debt of the United States increased from \$936.7 billion in 1980 to \$2.555 trillion in 1988. 67 FED. RESERVE BULL. A32, table 1.40 (Dec. 1981); 75 FED. RESERVE BULL. A30, table 1.40 (Jan. 1989).

the world, the United States has turned to foreign capital to finance this budget deficit.⁶ As a result, Japan, the world's largest creditor nation, has supplied funds which United States capital markets require.⁷

The United States Congress and leading economists agree that the only way to reduce the trade deficit between the two countries is to reduce the federal budget deficit.⁸ However, there continues to be disagreement as to the method.⁹ It is certain that until an effective federal budget deficit reduction plan is successfully implemented, reductions through other methods must continue. One such method is to eliminate entry barriers to Japanese securities markets. Elimination of such barriers could increase United States competition in Japanese markets thus allowing United States securities firms to capture a larger share. The result would be an inflow of capital to the United States economy, substantially reducing the trade deficit.¹⁰

This Comment examines both Japanese and United States securities laws as they apply to securities dealers of the other country. Emphasis is placed upon the specific Japanese restrictions imposed on United States securities firms, which if eliminated could substantially reduce the trade imbalance between the two countries. After comparing these restrictions, this Comment addresses the United States' recent attempt to eliminate such restrictions through a policy of protectionism. Finally, this Comment proposes that rather than try to force equal access through protectionist policies, the United States should negotiate a bilateral agreement with Japan which would grant equal access to United States securities dealers in Japanese securities markets.

6. Economic Relations Hearing, *supra* note 4, at 65; *United States Trade and Competitiveness: Hearing Before the Subcomm. on Economic Stabilization of the House Comm. on Banking, Finance and Urban Affairs*, 99th Cong., 1st Sess. 204-05 (1985) [hereinafter *Trade and Competitiveness Hearing*] (statement of Harry L. Freeman, Executive Vice President, The American Express Company).

7. Macroeconomic theory suggests that whenever a country imports necessary capital it will have a trade deficit. Likewise, whenever a country exports capital it will run a trade surplus. Capital from countries with trade surpluses is invested in countries with trade deficits. This is the current situation involving the United States and Japan. *Economic Relations Hearing*, *supra* note 4, at 65, 66.

8. *Id.* at 66.

9. *Id.*

10. Omnibus Trade and Competitiveness Act of 1988, § 3502(a)(2), Pub. L. No. 100-418, 102 Stat. 1107, 1386 (1988) [hereinafter *Primary Dealer's Act*].

II. PRINCIPLE AREAS OF UNEQUAL TREATMENT

There are four principle areas in which Japanese securities laws restrict United States firms from competition in Japanese securities markets.¹¹ Japanese law restricts a United States firm's ability to: (1) obtain a license to engage in the securities business in Japan;¹² (2) obtain membership on a Japanese bond exchange;¹³ (3) compete with Japanese firms on the basis of commissions;¹⁴ and (4) participate in the Japanese government bond market.¹⁵ While these restrictions have arisen as a result of Japanese culture and tradition, the Japanese should be encouraged to accept the responsibility that accompanies their role as a world economic leader and allow competition in Japanese securities markets by granting equal access to United States securities dealers.

A. Entry into Securities Markets

Japanese firms have a much easier time entering United States securities markets than United States firms entering Japanese securities markets. While Japanese law discriminates against United States dealers, the applicable United States laws treat United States and Japanese securities dealers equally.¹⁶ In fact, the United States has actively sought foreign investment and has only regulated foreign firms to the extent necessary to protect United States investors.¹⁷

1. Conducting Business in Japanese Securities Markets

The primary Japanese statutes concerning foreign securities dealers, the Foreign Securities Firms Law¹⁸ and the Securities and Exchange Law,¹⁹ are modeled after the United States Securities Act of

11. It should be noted that this Comment only analyzes those areas of unequal treatment set forth in the provisions of the Primary Dealer's Act, *supra* note 10.

12. *Id.* § 3502(a)(4)(E), (F).

13. *Id.* § 3502(a)(4)(A).

14. *Id.* § 3502(a)(4)(B).

15. *Id.* § 3502(a)(4)(C).

16. Requests for Comments on Issues Concerning Internationalization of the World Securities Markets, Exchange Act Release No. 21,958, 50 Fed. Reg. 16,302, 16,304 n.30 (1985). "The United States does not limit access by foreign broker-dealers to its securities markets." *Id.*

17. *Id.*

18. *Gaikoku Shōkengyōsha ni Kansuru Hōritsu* (Law on Foreign Securities Firms), Law No. 5 of 1971 [hereinafter Foreign Securities Firms Law].

19. *Shōken Torihiki Hō* (Securities and Exchange Law), Law No. 25 of 1948 [hereinafter Securities and Exchange Law].

1933²⁰ and the Securities Exchange Act of 1934.²¹ Though similar, when combined with other portions of Japanese law they severely limit a foreign dealer's ability to compete with Japanese firms in Japanese securities markets. The purpose of the Foreign Securities Firms Law is:

to open the way for foreign firms to engage in securities business through the establishment of a branch or branches in this country [Japan], and to contribute to a sound development of the capital market, as well as the protection of the investors by exercising appropriate control over their business.²²

The three methods by which a United States firm can conduct business in Japan indicate how unsuccessful the Japanese have been in fulfilling the stated purpose of the Foreign Securities Firms Law. Specifically, a United States firm is permitted to establish either a liaison, subsidiary, or branch office in Japan. The differences between these three methods of doing business are substantial and severely inhibit a firm's ability to engage in the securities business in Japanese securities markets.

The function of a liaison office is simply the collection and offering of information concerning the securities markets.²³ Liaison offices are not places of business and do not engage in direct profit making activities.²⁴ A license to do business is not required.²⁵ A firm seeking to open a liaison office must merely notify the Minister of Finance of the company's intent to open such an office.²⁶ The main benefit of opening a liaison office is substantially reduced regulation by the Japanese government.²⁷ However, the opening of a liaison office does not allow a United States firm direct entry into Japanese securities markets. The firm cannot transact orders with Japanese investors and cannot purchase Japanese securities, either for itself or on behalf of United States investors.

20. 15 U.S.C. § 77a (1982).

21. 15 U.S.C. § 78a (1982); 5 DOING BUSINESS IN JAPAN, pt. 8, ch. 1, at 6 (Z. Kitagawa ed. 1988).

22. Foreign Securities Firms Law, *supra* note 18, art. 1.

23. Z. Kitagawa, *supra* note 21, pt. 8, ch. 2, at 36.

24. 4 DOING BUSINESS IN JAPAN, pt. 7, ch. 4, at 16 (Z. Kitagawa ed. 1988).

25. Foreign Securities Firms Law, *supra* note 18, art. 31, para. 1.

26. *Id.*

27. For example, a liaison office may receive funds from its head office without being required to obtain a license from the Japanese Government. The firm does not have to submit a Branch Establishment Report as does a branch office. The office will not even be considered a place of business for tax purposes. Z. Kitagawa, *supra* note 24, pt. 7, ch. 4, at 16.

On the other hand, there is an indirect benefit to opening a liaison office. The primary purpose of opening such an office is to establish a foothold for the foreign firm in Japan. While the firm is not allowed to conduct securities transactions, it serves as a base for promotion of the firm's services in its home market.²⁸

Likewise, a United States firm could not enter Japanese securities markets by acquiring a Japanese subsidiary.²⁹ In order to acquire a Japanese subsidiary the acquiring firm must notify the Minister of Finance of its intent to acquire shares.³⁰ However, establishment of a subsidiary office for purposes of entering the securities business is impossible because the securities business is classified as a financial business under the Antimonopoly Act.³¹ Under the Antimonopoly Act those seeking to acquire a firm *engaged in a financial business* must obtain approval from the Fair Trade Commission prior to purchasing more than 5% of the outstanding shares.³² The Commission will not grant approval if the acquisition will bring about *control* of the business activities of the acquiree.³³ Such *control* would be deemed a substantial restraint on competition which is prohibited by the Act.³⁴ Thus, it is difficult for a United States firm to conduct the securities business in Japan by establishing a subsidiary because *control* is a necessity. To date, no Japanese firm has yet been acquired by a United States firm.

28. Miles, *Constraints on Broker-Dealers Operating Outside Their Home Country*, 4 J. COMP. CORP. L. & SEC. REG. 260, 262 (1982).

29. A subsidiary is a company which is owned and controlled by another company. Prior to April 27, 1973, Japan limited foreign acquisition of Japanese domestic companies to 50% or less of the company's total shares outstanding. However, in 1973 the Japanese liberalized this policy to allow 100% investment by foreigners. This was an attempt by the Japanese government to comply with the Convention on the Organization for Economic Cooperation and Development, Dec. 14, 1960. Japan's intent in liberalizing the policy was to "promote the internationalization of world economics and to contribute to world peace and prosperity through international cooperation in the area of business." Z. Kitagawa, *supra* note 24, pt. 7, ch. 2, at 7.

30. *Id.* The notification must include specific information about the character of the foreign investor, the type and amount of stock to be acquired, the objective of such investment, and time of execution. This notification is presented to the Minister of Finance, by way of the Bank of Japan, by a Japanese resident who is the acquiring firm's proxy. *Id.*

31. *Shiteki Dokusen no Kinshi Oyobi Kōsei Torihiki no Kakuho ni Kansuro Hōritsu* (Antimonopoly and Fair Trade Maintenance Act), Law No. 38 of 1947, art. 10, para. 2 [hereinafter Antimonopoly Act]. The purpose of the Act is to promote free and fair competition in the Japanese economy in order to protect the interests of consumers. *Id.* art. 1.

32. *Id.* art. 11. The Fair Trade Commission is responsible for administration and enforcement of the Antimonopoly Act. Z. Kitagawa, *supra* note 21, pt. 9, ch. 1, at 21.

33. Z. Kitagawa, *supra* note 21, pt. 9, ch. 4, at 7.

34. *Id.*

Despite existing barriers, the one possible method of United States entry into Japanese securities markets is the establishment of a branch office in Japan. A United States firm desiring to enter into transactions with a Japanese resident must obtain a license to do business³⁵ for each branch, and the firm.³⁶ A license is required for each type of securities business to be conducted.³⁷ Licenses are granted by the Ministry of Finance for the following transactions: buying and selling securities, acting as an intermediary, broker, or agent of persons buying and selling securities, underwriting the distribution of new securities or secondary offerings, and handling public offerings of new or outstanding securities.³⁸

Generally, the licensing requirements for foreign firms are identical to those for domestic firms.³⁹ To apply for a license, an application is filed pursuant to Ministry of Finance requirements.⁴⁰ When making the decision to grant a license, the Minister of Finance takes into consideration a number of different factors.⁴¹ The applicant must have sufficient capitalization to engage in the proposed business and must be a sound prospect for making a satisfactory profit.⁴² The firm

35. After World War II and prior to 1953, the Japanese had a registration system much like the current registration system used in the United States. However, in 1953 the Japanese replaced the registration system with a licensing system, which had been in place prior to World War II. JAPANESE SECURITIES REGULATIONS 109 (L. Loss, M. Yazawa & B. Banoff eds. 1983).

36. Prior to obtaining a license to do business the firm must appoint a Japanese representative for each branch office which will conduct the securities business. Securities and Exchange Law, *supra* note 19, arts. 3, 4. Next, the foreign company must file a "Report Concerning the Establishment of a Branch Office by an Exchange Non-Resident." This report must describe the planned activities of the proposed branch office. Foreign Securities Firms Law, *supra* note 18, art. 5(1). These requirements differ in application to Japanese firms in that Japanese firms are only required to obtain a license for the firm, while foreign firms must obtain a license for both the firm and each branch. Securities and Exchange Law, *supra* note 19, art. 2.

37. Foreign Securities Firms Law, *supra* note 18, art. 3, para. 1.

38. *Id.* art. 3, para. 3.

39. *Id.* Cf. Securities and Exchange Law, *supra* note 19.

40. Foreign Securities Firms Law, *supra* note 18, art. 4.

41. *Id.* art. 5. Cf. Securities and Exchange Law, *supra* note 19, art. 31.

42. Foreign Securities Firms Law, *supra* note 18, art. 5. The amount of capitalization varies with the type of business to be conducted. Those wishing to engage in the underwriting business must have capital as follows: managing underwriter currently engaging in securities business - ¥3 billion; managing underwriter engaging exclusively in underwriting business - ¥1 billion; non-managing underwriter engaging exclusively in underwriting business - ¥200 million. Broker-dealer licenses require capitalization as follows: regular member of the Tokyo or Osaka exchange - ¥100 million; regular member of Nagoya exchange - ¥50 million; regular member of other exchanges - ¥30 million; non-member who deals exclusively with securities companies and is located in a district outside Tokyo or Osaka - ¥20 million; firm which

must also have sufficient knowledge and experience to adequately carry out the securities business.⁴³ Finally, the proposed business must be necessary and appropriate in light of the number of securities transactions, the number of securities companies, and the number of total securities offices in existence.⁴⁴

In addition, the foreign firm must deposit a performance bond for each of its branches at an official depository located near each branch.⁴⁵ The purpose of this bond is to insure a "direct and ultimate guarantee of the payment capacity of foreign securities companies in Japan"⁴⁶ and to protect investors.⁴⁷ The amount to be deposited depends on the type of license, the mode of business, and the location of the branch.⁴⁸

Both domestic and non-domestic firms are denied licenses for a number of reasons.⁴⁹ If the capital of the company is inadequate a license will be denied.⁵⁰ A foreign firm's application will also be denied if the applicant is not a legal person of the same type as a Japanese stock company, has not engaged continuously for more than three years in the business of the same kind as that for which the license is sought, has illegally participated in the securities business, has been convicted for violation of any securities laws within the prior five years, or has had the securities license issued by his home country cancelled.⁵¹ A license may also be denied if the applicant, or any officer or representative of the applicant, has been bankrupt, has been convicted of a securities law violation within the prior five years, has worked for a firm whose domestic license has been cancelled within thirty days prior to the applicant's termination of employment, or has

deals exclusively with securities companies and has offices in Tokyo or Osaka - ¥4 million; firm that deals exclusively with securities companies and has offices outside of Tokyo or Osaka districts - ¥1 million. Distributors do not have to meet any capital requirements. Z. Kitagawa, *supra* note 21, pt. 8, ch. 2, at 6-7.

43. Securities and Exchange Law, *supra* note 19, art. 31(2).

44. *Id.* art. 31(3).

45. Foreign Securities Firms Law, *supra* note 18, art. 8, para. 1.

46. Z. Kitagawa, *supra* note 21, pt. 8, ch. 2, at 23.

47. *Id.*

48. *Id.* Generally, the amount to be deposited must be equivalent to one-tenth of the minimum stated capital required for that specific type of securities business. See *supra* note 42. If that amount is less than ¥10 million, the amount deposited must be equal to ¥10 million. Foreign Securities Firms Law, *supra* note 18, art. 8, para. 1.

49. Foreign Securities Firms Law, *supra* note 18, art. 6. Cf. Securities and Exchange Law, *supra* note 19, art. 32.

50. See *supra* note 42.

51. Foreign Securities Firms Law, *supra* note 18, art. 6. Cf. Securities Exchange Act of 1934, § 15(b)(4), 15 U.S.C. § 78o(b)(4) (1982).

been removed from his position under domestic securities laws.⁵²

In addition to obtaining a license, a foreign firm must register directors and employees who engage in the securities business, or related nonsecurities business, with the Ministry of Finance.⁵³ Those individuals who are not registered are prohibited from engaging in the securities business.⁵⁴

However, the entire licensing process is frustrated by the existence of a system known as "administrative guidance." Administrative guidance is a term which characterizes

the action of administrative organs, in respect to matters within a certain administrative field, in executing statutes by applying them, and in ordering strong measures against, and otherwise compelling, specific individuals, juristic persons and associations; where there is voluntary compliance and a statutory basis of action, in guiding, suggesting, and advising; and where there is voluntary compliance but no statutory basis of action, in influencing the parties' voluntary cooperation and consensual performance by expressing, as an administrative organ, the expectation and wish that something should exist or be done in a certain way.⁵⁵

In essence, administrative guidance is a means by which cooperation facilitates the expedition of a firm's application.⁵⁶ For example, a foreign firm seeking a license must fully cooperate with the Ministry of Finance or else its application will be denied.⁵⁷ Compliance is voluntary only in the sense that the party complies because of nonlegal incentives, such as threat of delay or denial, available to the administrative body.⁵⁸

52. Foreign Securities Firms Law, *supra* note 18, art. 6(7).

53. Securities and Exchange Law, *supra* note 19, art. 62, para. 1. These individuals are defined as registered representatives. *Id.*

54. Securities and Exchange Law, *supra* note 19, art 62, para. 2.

55. Narita, *Administrative Guidance*, 2 LAW IN JAPAN 45, 45-46 (1968). For a more detailed discussion of the definition of administrative guidance, see Yeomans, *Administrative Guidance: A Peregrine View*, 19 LAW IN JAPAN 125 (1986).

56. See Narita, *supra* note 55, at 52. The principle of "administrative guidance" developed in the post war era under the National Authority. In this postwar period it was found that formal authority was insufficient to deal with the many problems brought about by reconstruction, so Japan's administrative authorities gained unlimited power in areas not restricted by law. *Id.* at 49-50.

57. For examples of the applications of administrative guidance, see Smith, *The Japanese Foreign Exchange and Foreign Trade Control Law and Administrative Guidance: The Labrynth and the Castle*, 16 LAW & POLICY INT'L BUS. 417 (1984).

58. *Id.* at 420.

2. Registration in the United States as a Broker or Dealer⁵⁹

Entering the securities business in the United States is simpler than in Japan. The Securities Exchange Act of 1934 requires that any person who uses the mails or instrumentalities of interstate commerce to effect transactions of securities register as a broker or dealer.⁶⁰ This requirement is applicable to both domestic and foreign dealers.⁶¹ The registration process entails filing an application for registration with the Securities and Exchange Commission.⁶² A broker-dealer registration will not be granted if standards of operational capability are not met, and if the broker-dealer, or associated persons, does not meet standards of training, experience, and competence necessary for the

59. This Comment only discusses the registration of broker-dealers in general. The Government Securities Act of 1986 provides specific requirements for broker-dealers involved with the government securities market. For a discussion of the Government Securities Act, see Comment, *The Government Securities Act of 1986: Balancing Investor Protection with Market Liquidity*, 36 CATH. U. L. REV. 999 (1987).

60. Securities Exchange Act of 1934, § 15(a)(1), 15 U.S.C. § 78o(a)(1) (1982). The Exchange Act defines broker as "any person engaged in the business of effecting transactions in securities for the account of others . . ." *Id.* § 3(4), 15 U.S.C. § 78c(a)(4). The Act defines a dealer as "any person engaged in the business of buying and selling securities for his own account . . ." *Id.* § 3(17), 15 U.S.C. § 78c(a)(5). For a detailed discussion of broker-dealer registration, see Lipton, *A Primer on Broker-Dealer Registration*, 36 CATH. U. L. REV. 899 (1987).

61. Securities Exchange Act of 1934, § 3(17), 15 U.S.C. § 78c(a)(17) (1982). The Securities and Exchange Commission does allow foreign broker-dealers to transact with foreign nationals outside of the United States without being registered as a broker or dealer. The Commission, interpreting section 15 of the Securities Exchange Act, indicates that if a foreign broker-dealer either sells securities into the United States or purchases securities in the United States for United States nationals abroad they must be a registered broker-dealer. Registration of Underwriters of Foreign Offerings as Broker-Dealers, Exchange Act Release No. 7366, 33 Fed. Reg. 9828 (July 21, 1964). Foreign dealers must register if they intend to make sales to United States nationals, wherever such nationals may be. The United States broker-dealer standards only differ in application to non-domestic firms in that such firms must consent to service of process. Securities and Exchange Commission Rule 15b1-5, 17 C.F.R. § 240.15b1-5 (1988). See also Registration Requirements for Foreign Broker-Dealers, Exchange Act Release No. 25,801, 53 Fed. Reg. 23,645 (June 23, 1988).

62. Securities Exchange Act of 1934, § 15(b)(1), 15 U.S.C. § 78o(b)(1) (1982). Application for registration as a broker-dealer is to be made on Securities and Exchange Commission Form BD. Securities Exchange Commission Rule 15b1-1, 17 C.F.R. § 240.15b1-1 (1988). In addition, the Commission requires the applicant to file a statement of financial condition within thirty days of filing. Such statement must be detailed enough to disclose the nature and amount of the applicant's assets, liabilities, and net worth. The statement must also reflect the applicant's aggregate indebtedness, net capital, and include a list of securities in which the applicant has an interest. Securities and Exchange Commission Rule 15b1-2(a-c), 17 C.F.R. § 240.15b1-2(a-c) (1988). The applicant must also file a statement describing the broker-dealer's capital and stating that such capital will be maintained, and that the broker-dealer has and will continue to have adequate facilities and financing required for the carrying out of the securities business. *Id.* 15b1-2(c), 17 C.F.R. § 240.15b1-2(c).

protection of investors.⁶³ In addition, the applicant must not be subject to any statutory disqualification.⁶⁴

Within forty-five days of filing, the Commission is required to either grant registration or institute proceedings to determine if the registration should be denied.⁶⁵ If proceedings for denial are instituted the Commission must provide the applicant with notice of the reasons for denial and must give the applicant an opportunity for a hearing within 120 days of the date of filing the application.⁶⁶

If registration is granted, the Commission must make an inspection of the broker-dealer within six months to determine whether the broker-dealer conforms with provisions of the Securities Exchange Act and the Commission's rules and regulations.⁶⁷ At that time, if the Commission finds any violations which constitute grounds for suspension or revocation,⁶⁸ the Commission may censure, place limitations upon, suspend, or revoke the license of the broker-dealer as necessary in the public interest.⁶⁹ However, before the Commission revokes a broker-dealer registration, it must provide the broker-dealer with notice and an opportunity for a hearing.⁷⁰

At the conclusion of proceedings for denial, or after the six month inspection, the Commission may grant or deny registration if the requirements for approval still have not been met or if it finds that if the applicant were registered its registration would be subject to suspension or revocation.⁷¹

63. Securities Exchange Act of 1934, § 15(b)(7), 15 U.S.C. § 78o(b)(7) (1982).

64. Securities Exchange Act of 1934, § 15(b)(1), 15 U.S.C. § 78o(b)(1) (1982).

65. Securities Exchange Act of 1934, § 15(b)(1)(A-B), 15 U.S.C. § 78o(b)(1)(A-B) (1982).

66. Securities Exchange Act of 1934, § 15(b)(1)(B), 15 U.S.C. § 78o(b)(1)(B) (1982).

However, the 120 day period may be extended up to an additional ninety days if the Commission finds good cause for such an extension and publishes its reasons for doing so. *Id.*

67. Securities Exchange Act of 1934, § 15(b)(2)(C), 15 U.S.C. § 78o(b)(2)(C) (1982).

68. *See infra* note 77.

69. Securities Exchange Act of 1934, § 15(b)4, 15 U.S.C. § 78o(b)(4) (1982).

70. Securities Exchange Act of 1934, § 15(1)(B), 15 U.S.C. § 78o(1)(B) (1982).

71. Securities Exchange Act of 1934, § 15(b)(1), 15 U.S.C. § 78o(b)(1) (1982). Grounds for suspension or revocation require that it be in the public interest and that the broker or dealer, either before or after becoming a broker or dealer, has made false or misleading statements to the Commission, has been convicted within the ten years preceding the filing for impropriety involving securities or crimes of dishonesty, has been ordered by a court to cease any business involving securities transactions, has violated provisions of the securities laws, or has aided, abetted, counseled, commanded, induced, or procured the violation of any provisions of securities laws. *Id.* § 15(4), 15 U.S.C. § 78o(b)(4).

3. Unequal Treatment

The Japanese do not grant equal access to United States firms opening securities businesses in Japan. The Japanese do not allow a United States firm to acquire a Japanese firm. The Japanese only allow United States firms to conduct business after obtaining a license. The licensing process is far more complex than the United States broker-dealer registration process. The Japanese require a United States firm to put up a performance bond and register each employee. In addition, Japanese law does not delineate specific periods of time in which the Ministry of Finance is to grant or deny an application for a license. More importantly, Japanese law does not provide an opportunity for a hearing upon denial of an application for a license.

The United States, on the other hand, does not prohibit Japanese firms from opening securities offices in the United States nor does it prohibit the Japanese from acquiring existing United States firms. The United States merely requires that a Japanese firm file an application for broker-dealer registration. The United States does not require the deposit of a performance bond nor registration of each employee. The effect of such inequalities is that Japanese firms can easily enter the securities business in the United States while United States firms must navigate a long and complex channel of Japanese rules, regulations, unwritten standards, and cultural barriers.

B. Securities Exchange Membership

Membership on a securities exchange is important because it allows a firm to buy and sell securities directly on a securities exchange. Only members of an exchange are allowed to trade on the exchange. Those firms that are not members of an exchange must have their transactions executed by members of the exchange. Members charge non-members a commission for making a transaction. By being a member of an exchange, the firm can eliminate the expense of having to route transactions through an exchange member.

1. Membership on a Japanese Stock Exchange

Membership on a Japanese stock exchange is limited only to securities corporations.⁷² Each stock exchange is controlled and managed by the members of the Exchange who have the supreme decision

72. Securities and Exchange Law, *supra* note 19, art. 90. In the United States, membership is allowed to both corporations and individuals.

making authority.⁷³ These members also grant membership to foreign firms. Membership in the Japanese Securities Dealers Association is not required but suggested because of the important role of the Association.⁷⁴

2. Membership on a United States Stock Exchange

In general, each United States securities exchange enacts and implements its own rules regarding membership, subject, of course, to oversight by the Securities and Exchange Commission.⁷⁵ However, the Securities Exchange Act states that the national exchange to which an applicant is applying must deny membership if the applicant is not a registered broker-dealer, or if a natural person, is not associated with a registered broker-dealer.⁷⁶ Membership may, or if deemed by the Commission to be necessary and appropriate in the public interest, must, be denied if the applicant is subject to a statutory disqualification.⁷⁷ In addition, the exchange may deny or condition membership upon satisfying standards of financial responsibility or operational capability. The application may be denied if the broker-dealer or a person associated with them has engaged in, or there is a reasonable likelihood that that person has engaged in, or may in the future engage in, practices or acts inconsistent with just and equitable principles of trade, or if the applicant does not meet minimum standards of training, experience, and competence, refuses to supply the exchange with information regarding its dealings with the exchange, or refuses to permit examination of its books and records for purposes of verifying their accuracy.⁷⁸ The exchange may also deny membership in order to limit the number of members of the exchange.⁷⁹

Once the firm has been approved as a broker-dealer it must become a member of a securities association registered pursuant to the

73. Z. Kitagawa, *supra* note 21, pt. 8, ch. 3, at 17.

74. L. Loss, *supra* note 35, at 79.

75. Securities Exchange Act of 1934, § 6, 15 U.S.C. § 78f (1982).

76. Securities Exchange Act of 1934, § 6(c)(1), 15 U.S.C. § 78f(c)(1) (1982).

77. Securities Exchange Act of 1934, § 6(c)(2), 15 U.S.C. § 78f(2) (1982). An applicant is subject to a statutory disqualification if the applicant has been and is expelled or suspended from membership or participation in any trading market, is subject to a regulatory agency order suspending or revoking the applicant's registration, has been found to be the cause of any effective suspension, has associated with any person known to be statutorily disqualified, has been convicted of any wilful violation or aided and abetted a violation of any of the securities acts, or has been convicted within the ten years preceding the filing of application of any felony or misdemeanor relating to the securities markets. *Id.* § 3(39), 15 U.S.C. § 78c(39).

78. Securities Exchange Act of 1934, § 6(c)(3), 15 U.S.C. § 78f(c)(3) (1982).

79. Securities Exchange Act of 1934, § 6(c)(4)(A), 15 U.S.C. § 78f(c)(4)(A) (1982).

Securities Exchange Act.⁸⁰ This means the firm must apply to the only securities association registered pursuant to section 15(b)(8) of the Securities Exchange Act, the National Association of Securities Dealers (NASD).⁸¹

3. Unequal Treatment

United States firms have experienced difficulty in obtaining seats on Japanese securities exchanges because there are no enunciated standards by which a United States firm can obtain membership. Traditionally, members of a Japanese securities exchange have been a close knit group who are wary of granting membership to outsiders. Further, members would rather have United States firms route their transactions through existing Japanese brokers.

The first foreign firms were allowed membership on the Tokyo Stock exchange in 1985.⁸² To date, only a few foreign firms have been granted membership on the Tokyo Stock Exchange. Japanese officials have claimed that they have not allowed more foreigners exchange membership because of a lack of space at the exchange and efforts to computerize the trading floor.⁸³

On the other hand, the United States has very detailed rules which allow exchange membership, for both domestic and foreign firms, so long as the firm complies with broker-dealer registration requirements.⁸⁴ As a result, foreign firms have been allowed membership on the New York Stock Exchange, regional exchanges, as well as in the National Association of Securities Dealers.⁸⁵

80. Securities Exchange Act, § 15(b)(8), 15 U.S.C.A. § 78o(b)(8) (West Supp. 1988). However, the firm is not required to become a member of a securities association if it is a member of a national securities exchange, carries no customer accounts, and has annual gross income from securities transactions less than or equal to \$1,000. Securities and Exchange Commission Rule 15b9-1, 17 C.F.R. § 240.15b9-1 (1988).

81. The application procedure is quite simple. The applicant must merely apply to the Association and accept and agree to Association rules, pay dues, not hold the Association liable, and to provide the Association with required information. NASD Bylaws, NASD Manual (CCH), art. III, para. 1131, § 1(a) (1988).

82. *Britain Seeks More Seats for Its Firms On Tokyo Stock Exchange, Mulls Sanctions*, Wall St. J., Apr. 7, 1987, at 31.

83. *Id.*

84. Williams & Spencer, *Regulation of International Securities Markets: Towards A Greater Cooperation*, 4 J. COMP. CORP. L. & SEC. LIT. 279, 282 (1982). See also Securities Exchange Act of 1934, § 6(c)(1), 15 U.S.C. § 78f(c)(1) (1982).

85. Williams & Spencer, *supra* note 84, at 282; Pozen, *Disclosure and Trading in an International Securities Market*, 15 INT'L LAW 84, 90 (1981).

C. Brokerage Commissions

The commission structure is of significant importance in the competitive workings of any securities market. In those markets where variable commissions are allowed, brokers can attract clients by lowering their commission rates. However, in markets that have a fixed rate structure, all brokers must charge the fixed rate, thus eliminating the opportunity to attract clients on the basis of commission rates.

1. Japan's Fixed Brokerage Commissions

In Japan, securities exchanges are required to fix commission rates⁸⁶ and exchange members are required to charge their customers the fixed rate.⁸⁷ For example, the Tokyo Stock Exchange has both a fixed brokerage charge plus a sliding scale fee.⁸⁸ These fixed rates are the highest in the world and range from 1.25% for transactions under ¥10 million to 0.15% for transactions over ¥1 billion.⁸⁹

2. United States Negotiated Commission Rates

United States stock exchanges may not directly or indirectly require members to charge fixed commission rates.⁹⁰ This is a result of the long history of the fixing of commissions by securities exchanges.⁹¹ In *Gordon v. New York Stock Exchange*,⁹² the United

86. Commissions are the amount which securities brokers charge clients for executing orders. The policy of fixing commissions presents no antitrust problems under Japanese law because securities exchanges are exempt from application of the Antimonopoly Act. 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 11.04[3] (H. Bloomenthal ed. 1986).

87. Securities and Exchange Law, *supra* note 19, art. 191. These rates are indirectly fixed by the Minister of Finance. The exchange sets the fixed price in its entrustment contract regulations. Under the Securities Exchange Law, a securities exchange is required to have a constitution, business regulations, and entrustment contract regulations which cannot be amended without the approval of the Minister of Finance. The Minister of Finance may order the exchange to amend such provisions. Securities and Exchange Law, *supra* note 19, arts. 82, para. 2, 85-1, para. 1, and 156. See also INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATIONS, *supra* note 86, § 11.02[2][a].

88. *Chop Chop*, ECONOMIST, June 20, 1987, at 81, 82. In Japan the average investor pays between 1.25-0.15% in commissions while in London commissions for institutional investors are between 0.34-0.22% and on Wall Street of 0.6-0.3%. *Id.*

89. *Id.*

90. Securities and Exchange Commission Rule 19b-3, 17 C.F.R. § 240.19b-3 (1988).

91. For a discussion of the history of commission fixing in United States securities markets, see *Gordon v. New York Stock Exchange*, 422 U.S. 659 (1975). See also 40 Fed. Reg. 7394 (1975).

92. 422 U.S. 659.

States Supreme Court affirmed the power of the Securities and Exchange Commission to regulate a securities exchange's rate fixing practices for the protection of investors. Just prior to the decision in *Gordon*, the Securities and Exchange Commission found,

it is necessary and appropriate (1) for the protection of investors, (2) to insure fair dealing in securities traded upon national securities exchanges, and (3) to insure the fair administration of such exchanges, that the rules and practices of such exchanges that require, or have the effect of requiring, exchange members to charge any persons fixed minimum rates of commission, should be eliminated.⁹³

Gordon and the Commission findings resulted in Securities and Exchange Commission Rule 19b-3⁹⁴ which facilitated competition among brokers by elimination of fixed commissions. Brokers desiring to attract new clients merely reduce their commission rates thereby reducing the cost to their clients.

3. Unequal Treatment

The disparity between the two countries commission rate systems is substantial. When Japanese firms do business in the United States, they are free to compete for United States investors on the basis of commissions. If Japanese firms want to lower their commission rates below those of United States firms to attract United States investors they may do so. When United States firms engage in the securities business in Japan they are forced to charge the fixed rate required by the exchange. As a result, United States firms cannot compete in Japanese securities markets for Japanese investors by offering lower commissions.

D. The Government Securities Markets

1. The Japanese Government Bond Market

In Japan, as in the United States, the issuance of government debt securities finances the national debt. There are three types of Japanese government debt securities available: short, medium, and long term issues.⁹⁵ An auction system currently exists for the sale of

93. *Id.* at 674-75.

94. 17 C.F.R. § 240.19b-3 (1988).

95. The Japanese do not have government issues beyond the maturity of twenty years because of the size of the national deficit. Short term government issues mature after six

both short and medium term issues.⁹⁶ However, the Ministry of Finance requires that those who wish to participate in the auction be members of the government securities underwriting syndicate, and hold an account with the Bank of Japan.⁹⁷

Long term Japanese government debt is currently sold to a syndicate controlled by Japanese institutions.⁹⁸ The Japanese bond syndicate is similar to a syndicate formed for the issuance of stock in that syndicate members bear the risk for any unsold portions of the issuance.⁹⁹ However, there is substantial interference by the Japanese government.¹⁰⁰ For example, the Japanese Ministry of Finance more or less dictates the terms of the debt issuance by negotiating the offering price with the underwriting syndicate prior to the issuance.¹⁰¹

2. The United States Government Securities Market

Buying and selling United States government securities assists the Department of the Treasury in financing government debt, and provides the Federal Reserve with a means of implementing monetary policy.¹⁰² The Treasury issues government securities to primary dealers through an auction system.¹⁰³ These issues are sold in both primary and secondary markets. Primary dealers are those dealers that buy and sell government securities directly with the Federal Reserve Bank of New York.¹⁰⁴ These primary dealers in turn offer govern-

months. Medium term government issues mature after 2, 3, 4, or 5 years. Long term government issues mature after ten or twenty years

96. *Sharing the Government Bond Pie: A Fair Slice of the Pie Depends on the Point of View*, EUROMONEY, Mar. 1987, at 126, 128. See *Houses Find Treasury Bond System Archaic*, SUPPLEMENT TO EUROMONEY, Apr. 1987, at 85, 85 [hereinafter Special Supplement].

97. *Sharing the Government Bond Pie*, *supra* note 96, at 128.

98. *Japanese Plan Auction Sales of Some Bonds*, Wall St. J., May 12, 1987, at 29, col. 1. Japan's long term government debt securities include five-year discount bonds, ten-year bonds, and twenty-year bonds. Special Supplement, *supra* note 96, at 85. This syndicate is currently comprised of 800 members. *Japan Will Use Price Auction System To Sell 40 Percent of New 10-Year Bonds*, 20 Sec. Reg. & L. Rep. (BNA) 1401 (Sept. 16, 1988).

99. See *Japanese Bond Plan Disappoints Firms*, N.Y. Times, June 6, 1987, at 39, col. 6.

100. See Special Supplement, *supra* note 96, at 85.

101. *Id.*

102. FEDERAL RESERVE BANK OF RICHMOND, INSTRUMENTS OF THE MONEY MARKET 30 (1981).

103. *Id.*

104. BROKER-DEALERS 1985: REGULATIONS AND LITIGATION, PRACTISING LAW INSTITUTE 97 (1985) [hereinafter BROKER-DEALERS]. The Federal Reserve Bank of New York is primarily responsible for conducting the Federal Reserve's open market operations. Open market operations are the tool used by the Federal Reserve, as the nation's central bank, to influence the costs and availability of money and credit. Federal Reserve Bank of New York, Fedpoints 2: Primary Dealers Defined (Feb. 1988).

ment securities to secondary dealers.¹⁰⁵

In December 1985, the Federal Reserve Bank of New York initially outlined the standards and procedures to be used to determine whether a firm should be designated as a primary dealer.¹⁰⁶ A firm seeking primary dealer status is expected to fulfill a number of requirements: to make markets in the full range of Treasury issues for a reasonably diverse group of customers,¹⁰⁷ participate meaningfully in Treasury auctions,¹⁰⁸ evidence management depth and experience, good internal controls and commitment to continue participation as a market-maker over the long term, must have sufficient capital to support their activities, and manage their risk exposure prudently within the bounds of their capital.¹⁰⁹

The firm desiring to become a primary dealer does not have to make a formal application for primary dealer status, but rather needs only file an informal declaration of its intent to become a primary dealer.¹¹⁰ Thereafter, the firm begins to submit daily, weekly, and monthly reports on its market positions, financial performance, and volume of customer business.¹¹¹ Once reporting commences, the Federal Reserve Bank reviews the reports until a time at which it feels it is appropriate to grant primary dealer status.¹¹²

The Federal Reserve recently revised these guidelines in November of 1988.¹¹³ It strengthened the existing guidelines by increasing the minimum capital level for dealers from \$25 million to \$50 million and increased the dealer's minimum required trading volume from .75% to 1.0%.¹¹⁴ In addition, the Federal Reserve stated it would not designate nor continue to designate, after August 1989, foreign firms

105. *BROKER-DEALERS*, *supra* note 104, at 98. Secondary dealers are those dealers that trade government securities with primary dealers and general investors.

106. Dealer Surveillance Staff, Federal Reserve Bank of New York, *Primary Dealers: Criteria and Process for Firms Interested in Becoming Primary Dealers* (Dec. 1985).

107. *Id.* at 1. The minimum amount of trading volume required to be traded with customers is to be about .75%. *Id.*

108. The primary dealer is expected to submit auction bids of a size commensurate with that dealer's capacity in a realistic price range relative to market conditions. *Id.* at 2.

109. *Id.* at 1.

110. *Id.* at 3.

111. *Id.* at 3-5.

112. It is an unwritten rule of the Federal Reserve that if a firm has been reporting for more than a year it will be dropped from the list of those being seriously considered for primary dealer status. *New York Fed Adds Three Primary Dealers To List, But Passes Over Japanese House*, 20 *Sec. Reg. & L. Rep.* (BNA) 1066 (July 8, 1988).

113. *New York Fed Adopts Stricter Standards for Gaining Primary Dealer Designation*, 20 *Sec. Reg. & L. Rep.* (BNA) 1793 (Nov. 25, 1988).

114. *Id.*

as primary dealers until it had determined that the firm's home country granted United States firms the same competitive opportunities as the United States does to the home country's domestic firms.¹¹⁵

There are currently forty-six primary dealers in the United States government securities market, fifteen of which are foreign firms.¹¹⁶ These foreign firms account for 15% of the overall bond allocation.¹¹⁷

3. Unequal Treatment

The overall inequality regarding participation in the United States and Japanese government securities markets is due to the fact that both markets are so different.¹¹⁸

In Japan, the syndicate is similar to a United States securities underwriting syndicate. The syndicate underwriters and members dictate who will participate in the offering, as well as what percentage of the debt offering specific members will obtain. The price of each offering is negotiated between the syndicate and the Ministry of Finance.

In the United States, on the other hand, the sale of government securities is conducted through a governmental entity, the Federal Reserve Bank of New York. The Bank, and not the primary dealers, is the one that determines with whom it will deal. The allocation of United States government securities is determined through an auction system. The price is also determined through this system. The primary dealers with the highest bids in the auction are the ones who obtain the largest amount of the offering.

In both systems the criteria for becoming a primary dealer or syndicate member are not specifically delineated. In Japan, syndicate members have not specifically delineated what is required for syndicate membership. In the United States, the Federal Reserve Bank of New York's standards for primary dealer status are merely guidelines. Members who meet the Federal Reserve's standards still may not be granted primary dealer status even though they are qualified.

Despite the Federal Reserve guidelines, Japanese firms have re-

115. *Id.*

116. *Federal Reserve Names Japanese Securities Company As Primary Dealer*, 20 Sec. Reg. & L. Rep. (BNA) 1521 (Oct. 7, 1988). Of the fifteen non-United States firms that have been designated as primary dealers, seven are Japanese, five British, and one each from Canada, Australia, and Hong Kong. *Id.*

117. *Supra* note 96.

118. *Trade Bill Conferees Agree on Limits For Foreign Dealers in United States Securities*, Wall St. J., Mar. 31, 1988, at 3, col. 4.

ceived access to the United States government securities market while United States firms participating in the Japanese government bond market are restricted from access. For example, in 1986 the Japanese trading syndicate successfully excluded United States banks and securities dealers from participation in government bond offerings. Eleven United States firms were allocated only .77% of all such instruments distributed.¹¹⁹ These eleven firms were included in a group of twenty-five foreign banks and seventeen foreign securities companies which shared 1% of the total offering.¹²⁰ Most United States firms believe the system to be unfair and are urging that an auction system, much like the one used in the United States, and Japanese short and medium term markets, be implemented.¹²¹ The Ministry of Finance is reluctant to issue long term government debt in such a manner due to the possibility that such auctions may cost more.¹²² Japanese commercial banks and insurance companies, who are allocated 76% of the offering from the syndicate, fear losing much of their business in such auctions.¹²³ On the other hand, United States firms feel that an auction system would actually reduce the cost of borrowing.¹²⁴ In reality, the Japanese concern is that the auction may not sell an entire issue of new debt.¹²⁵ After all, a good percentage of the issue is used to refinance redemptions of expiring bonds.¹²⁶

III. THE UNITED STATES ATTEMPT TO ELIMINATE RESTRICTIVE PRACTICES

A. *Primary Dealers Act of 1988*

The United States has attempted to unilaterally force Japan to eliminate restrictions upon foreign securities dealers through enactment of the Primary Dealers Act of 1988.¹²⁷ The Act specifically at-

119. *Japanese Plan Auction Sales of Some Bonds*, *supra* note 98, at 29.

120. *Sharing the Government Bond Pie*, *supra* note 96, at 127.

121. *See* Special Supplement, *supra* note 96, at 87.

122. *Sharing the Government Bond Pie*, *supra* note 96, at 127.

123. *Id.*

124. *Id.* at 131.

125. *Foreign Firms Not Unhappy With Their Share of Japanese Gov't Bond Market*, 18 Sec. Reg. & L. Rep. (BNA) 1750 (Dec. 5, 1986).

126. *Id.* at 128.

127. *Supra* note 10, §§ 3501, 3502 (1987). This was not the first attempt at eliminating Japanese restrictions upon United States securities dealers. The Primary Dealer's Act had previously been introduced in a number of different forms. *See* H.R. 4848, 100th Cong., 2nd Sess. §§ 3501, 3502 (1988); H.R. 3, 100th Cong., 1st Sess. § 3501, 3502 (1987); S. 1409, 100th Cong., 1st Sess. §§ 601, 602 (1987); S. 1101, 100th Cong., 1st Sess. (1987); H.R. 1463, 100th Cong., 1st Sess. (1987); H. Con. Res. 403, 99th Cong., 2nd Sess. (1986). The text of each

tempts to eliminate Japanese discrimination against United States firms.¹²⁸ It prohibits the Board of Governors of the Federal Reserve system and the Federal Reserve Bank of New York from designating, or continuing to designate, a foreign person as a primary dealer in United States government debt instruments if that person's home country does not allow United States firms equal access to that country's government debt markets.¹²⁹ The Act is based upon findings that United States companies can successfully compete in foreign markets, a trade surplus in services could help lower the overall trade deficit between the United States and Japan, United States firms have been excluded from Japanese debt offerings, and Japanese firms face

version was virtually the same. However, S. 1409 and S. 1101 additionally provided for equal treatment of United States banks and bank holding companies. See S. 1409, 100th Cong., 1st Sess § 601 (1987); S. 1101, 100th Cong., 1st Sess. § 2 (1987).

128. S. Rep. No. 85, 100th Cong., 1st Sess. 5 (1987).

129. Primary Dealer's Act, *supra* note 10, § 3502.

SEC. 3502. REQUIREMENT OF NATIONAL TREATMENT IN UNDERWRITING GOVERNMENT DEBT INSTRUMENTS.

(a) FINDINGS.—The Congress finds that—

(1) United States companies can successfully compete in foreign markets if they are given fair access to such markets;

(2) a trade surplus in services could offset the deficit in manufactured goods and help lower the overall trade deficit significantly;

(3) in contrast to the barriers faced by United States firms in Japan, Japanese firms generally have enjoyed access to United States financial markets on the same terms as United States firms; and

(4) United States firms seeking to compete in Japan face a variety of discriminatory barriers effectively precluding such firms from fairly competing for Japanese business, including—

(A) limitations on membership on the Tokyo Stock Exchange;

(B) high fixed commission rates (ranging as high as 80 percent) which must be paid to members of the exchange by nonmembers for executing trades;

(C) unequal opportunities to participate in and act as lead manager for equity and bond underwritings;

(D) restrictions on access to automated teller machines;

(E) arbitrarily applied employment requirements for opening branch offices;

(F) long delays in processing applications and granting approvals for licenses to operate; and

(G) restrictions on foreign institutions' participation in Ministry of Finance advisory councils.

(b) DESIGNATION OF CERTAIN PERSONS AS PRIMARY DEALERS PROHIBITED.—

(1) GENERAL RULE.—Neither the Board of Governors of the Federal Reserve System nor the Federal Reserve Bank of New York may designate, or permit the continuation of any prior designation of, any person of a foreign country as a primary dealer in government debt instruments if such foreign country does not accord to United States companies the same competitive opportunities in the underwriting and distribution of government debt instruments issued by such country as such country accords to domestic companies of such country.

(2) CERTAIN PRIOR ACQUISITIONS EXCEPTED.—Paragraph (1) shall not

few barriers in accessing United States markets.¹³⁰ More importantly, however, the Act recognizes that United States firms face discriminatory barriers to Japanese securities markets.¹³¹ These barriers include long delays in processing applications and granting approvals for licenses to operate, arbitrarily applied employment requirements for opening branch offices, limitations on membership on the Tokyo Stock Exchange, and high fixed commission rates.¹³²

The underlying purpose of the Act is to force the Japanese to open their securities markets or else risk closure of United States markets to Japanese dealers. Thus, the Act operates to unilaterally coerce reciprocity.¹³³ When enforced, the Act requires that the Federal Reserve Bank of New York not designate, nor continue to designate, Japanese firms as primary dealers in the United States government debt markets unless Japan grants equal access to United States firms. Those Japanese firms not designated as primary dealers would pressure the Japanese government to eliminate restrictions imposed on United States firms in Japanese securities markets.

apply to the continuation of the prior designation of a company as a primary dealer in government debt instruments if—

- (A) such designation occurred before July 31, 1987; and
- (B) before July 31, 1987—

- (i) control of such company was acquired from a person (other than a person of a foreign country) by a person of a foreign country; or
- (ii) in conjunction with a person of a foreign country, such company informed the Federal Reserve Bank of New York of the intention of such person to acquire control of such company.

(c) EXCEPTION FOR COUNTRIES HAVING OR NEGOTIATING BILATERAL AGREEMENTS WITH THE UNITED STATES.—Subsection (b) shall not apply to any person of a foreign country if—

- (1) that country, as of January 1, 1987, was negotiating a bilateral agreement with the United States under the authority of section 102(b)(4)(A) of the Trade Act of 1974 (19 U.S.C. 2112(b)(4)(A)); or

- (2) that country has a bilateral free trade area agreement with the United States which entered into force before January 1, 1987.

(d) PERSON OF A FOREIGN COUNTRY DEFINED.—For purposes of this section, a person is a “person of a foreign country” if that person, or any other person which directly or indirectly owns or controls that person, is a resident of that country, is organized under the laws of that country, or has its principal place of business in that country.

(e) EFFECTIVE DATE.—This section shall take effect 12 months after the date of the enactment of this Act.

Id.

130. Primary Dealer's Act, *supra* note 10, at § 3502 (a)(1-4).

131. *Id.* § 3502 (a)(5)(A-D).

132. *Id.*

133. Reciprocity traditionally has been described as a relationship between two states in which each state gives the subjects of the other certain privileges in return for similar privileges.

B. Effectiveness of The Primary Dealers Act

The effectiveness of the Act is questionable.¹³⁴ While its purpose is to pressure the Japanese to allow United States dealers equal access to the Japanese government bond market, it will not do so for a number of reasons.

First, the Primary Dealer's Act is contrary to current United States policy regarding international regulation of securities markets. The United States currently favors bilateral negotiation to unilateral action. In the past the United States has unsuccessfully attempted to enforce unilateral application of its securities laws to foreign persons.¹³⁵ The primary attempt was embodied in the "waiver by conduct" approach.¹³⁶ The "waiver by conduct" approach required foreign investors who traded in United States markets to waive the protections otherwise afforded by secrecy laws and blocking statutes of other countries as a precondition to trading.¹³⁷ If the foreign investor did not waive such protections, they would be prevented from trading in United States markets.¹³⁸ From the outset, the proposed approach was highly controversial.¹³⁹ The Reagan administration and the Treasury Department were opposed to the approach on grounds that it would "run counter to the administration's goals of encouraging the free flow of capital across borders, enhancing international economic cooperation, and reducing unnecessary restraints on foreign and international financial and banking activities."¹⁴⁰ The

134. It should be noted, however, that immediately after the Primary Dealer's Act became law, the Japanese Ministry of Finance announced that 40% of the 10 year bond market would be auctioned rather than sold through a syndicate. These auctions are scheduled to commence in April of 1989. 20 Sec. Reg. & L. Rep. (BNA) 1521 (Oct. 7, 1988). Also, the Ministry of Finance agreed to increase the foreign share of bonds allocated through the underwriting syndicate from 2.5% to 8%. 20 Sec. Reg. & L. Rep. (BNA) 1401, 1402 (Nov. 16, 1988). The Ministry also stated that four foreign firms would be allowed to become co-managers of the syndicate responsible for fixing allocations. *Id.* In addition, those syndicate members with less than a .3 percent share of the underwriting syndicate would be allowed to buy their bonds through a noncompetitive tender. *Id.*

135. See Haseltine, *International Regulation of Securities Markets: Interaction Between the United States and Foreign Laws*, 36 INT'L & COMP. L. Q. 307, 308 (1987); Note, *Enforcing Securities Regulations Through Bilateral Agreements with the United Kingdom and Japan: An Interim Measure or a Solution*, 23 TEX. INT'L L. J. 251, 263-64 (1988). For a discussion of the "waiver by conduct" approach, see *The SEC Goes International*, N.Y.L.J., June 20, 1985, at 1, col. 1.

136. Haseltine, *supra* note 135, at 309.

137. *Id.* at 310.

138. *Id.*

139. *Id.*

140. *Id.* at 311.

most important of the reasons is that this unilateral approach would complicate efforts aimed at international cooperation.¹⁴¹ As a result of such concerns the unilateral approach was replaced by a more productive system comprised of bilateral negotiation.¹⁴²

Second, reduction of Japanese participation in the primary dealer market would be detrimental to the United States economy. The sale of United States Treasury issues is primarily used to finance the enormous United States debt. Exclusion of the Japanese would reduce the overall demand for United States government securities.¹⁴³

The ultimate effect would be a reduction in the quantity of bonds sold, a lower price paid for such securities, as well as a rise in interest rates.¹⁴⁴ In effect, the Act is anti-competitive because it reduces competition in the government securities market.

Such a reduction in proceeds derived from the bond issues could have a detrimental effect on the United States' ability to repay interest on the debt. For example, in a six month period Japanese investors purchased about \$667.4 billion worth of United States government bonds.¹⁴⁵ Reducing the amount of funds in Treasury issues by that amount would be devastating.

Third, exclusion of the Japanese from the primary market would simply shift Japanese interest towards the secondary market. While Japanese brokers would make less profit from buying and selling Treasury issues in secondary markets, Japanese institutional investors could still purchase the issues they would require. As an alternative to the secondary market, the Japanese could always purchase other types of long term debt. This would be inconsistent with the purpose of the Act because while Japanese dealers would complain, to the Japanese government, that they are being denied access, Japanese investors would not.

Fourth, the Act only addresses one area of restriction, the Japanese government bond market. The Act does not address Japanese restrictions on United States firms opening an office in Japan, membership on Japanese securities exchanges, or Japan's fixed commission rates. Unequal treatment would only be remedied, if at all, in the government securities market. Such a remedy is inconsistent with the

141. Note, *supra* note 135, at 264.

142. *Id.*

143. 20 Sec. Reg. & L. Rep. (BNA) 1401, 1402 (Nov. 16, 1988).

144. *Id.*

145. *Japanese Slow Investments in U.S. Markets*, L.A. Times, Nov. 7, 1987, pt. IV, at 2, col. 1.

findings of the Act that restrictions exist in other areas.¹⁴⁶

Fifth, the Act fails to address the situation where a Japanese firm acquires, either in whole or in part, a United States government securities dealer who has achieved primary dealer status. For example, on December 19, 1988, the Federal Reserve Board approved Fuji Bank Ltd.'s application to acquire 24.9% of the voting shares of Kleinwort Benson Government Securities Inc.¹⁴⁷ The majority of the Board held that the Primary Dealer's Act of 1988 did not bar the acquisition.¹⁴⁸ The Board based its holding on grounds that the Act does not become effective until August 23, 1989.¹⁴⁹ The Board indicated that even after the effective date it would not be required, by the Act, to deny such an acquisition unless it had first determined that Japan "does not accord United States institutions the same competitive opportunities it affords to domestic companies in its government debt markets."¹⁵⁰

The Board's decision leads to the sixth, and most compelling reason why the Act will be ineffective. The Act does not define what is meant by "same competitive opportunities."¹⁵¹ Was the intent of Congress to rectify only those inequalities in the government securities markets, or in all areas of unequal treatment? What standard will

146. See Primary Dealer's Act, *supra* note 10, § 3502(a).

147. *Fed Lets Fuji Bank Buy Shares of Chicago-Based Primary Dealer*, 21 Sec. Reg. & L. Rep. (BNA) 27 (Jan. 6, 1989). Previously, in February 1988, another Japanese Bank, Long Term Credit Bank of Japan, applied to the Fed for permission to buy an existing primary dealer, Greenwich Capital Markets Inc. *Long Term Credit Bank of Japan Seeks to Buy United States Primary Dealer*, 20 Sec. Reg. & L. Rep. (BNA) 301 (Feb. 26, 1988).

148. 21 Sec. Reg. & L. Rep. (BNA) 27 (Jan. 6, 1989).

149. *Id.* Aside from the Board's holding regarding interpretation of the Primary Dealer's Act, the Board held that Fuji was in compliance with the capital requirements the Board set forth in the Board's Capital Adequacy Guidelines. While Fuji's publicly reported capital was less than required, the Board made an adjustment after taking into consideration Japanese banking and accounting practices. *Id.*

150. *Id.*

151. See Primary Dealer's Act, *supra* note 10, § 3502(b)(1). The Reagan Administration objected to the Primary Dealer's Act not only because of its protectionist nature, but also because the Act did not give the administration discretion to determine whether Japanese markets granted equal access. See *Trade Bill Conferees Agree on Limits For Foreign Dealers in United States Securities*, Wall St. J., Mar. 31, 1988, at 3, col. 4. Yet, as a result of Congress' failure to define "same competitive opportunities," Congress has, in effect, given the administration discretion to determine whether equal access is present. For example, see text accompanying notes 143-146. Paul Volcker, Chairman of the Board of Governors of the Federal Reserve, and Gerald Corrigan, President of the Federal Reserve Bank of New York, opposed the Act for similar reasons. See *Trade Bill May Strip Japanese Firms of Gov't Securities Dealer Status*, 19 Sec. Reg. & L. Rep. (BNA) 443 (Mar. 27, 1987); *New York Fed President Opposes Primary-Dealer Restrictions in Trade Bill*, 19 Sec. Reg. & L. Rep. (BNA) 671 (May 8, 1987).

satisfy the "same competitive opportunities" wording? Do we require total equality, or just a good faith effort in achieving total equality? Even the Act's author, Representative Charles Schumer of New York, doesn't know what would be required to satisfy the "same competitive opportunities" standard.¹⁵²

Seventh, the Act does not provide for the situation where a Japanese firm has previously acquired a United States primary dealer. In fact, the Act specifically exempts such an acquisition under its "grandfather clause."¹⁵³ Under the clause, if such an acquisition occurred prior to July 31, 1987, and if the acquiror and the target primary dealer notified the Federal Reserve Bank of New York of the proposed acquisition prior to that date, the acquisition will not be reversed.¹⁵⁴ For example, on June 6, 1988 the Federal Reserve Board approved Sanwa Bank Ltd.'s application to acquire Brophy, Gestal, Knight & Co., L.P., as well as Long Term Credit Bank of Japan's application to acquire Greenwich Capital Markets pursuant to the clause.¹⁵⁵

If this type of protectionist legislation is to be effective it must prevent the Japanese from buying any United States government securities, both in the primary and secondary markets. As a result, Japanese dealers and investors would pressure the Japanese government to open its markets to United States dealers. However, such legislation totally restricting the Japanese from purchasing any United States government securities would be catastrophic. For example, Japan contributes almost \$40 billion a year towards financing of the United States deficit.¹⁵⁶ To reduce the amount of foreign funds in the United States markets by that amount would be cataclysmic.¹⁵⁷

152. See *Japan Will Use Price Auction System to Sell 40 Percent of New 10-Year Bonds*, 20 Sec. Reg. & L. Rep. (BNA) 1401, 1402 (Sept. 16, 1988).

153. See *Primary Dealer's Act*, *supra* note 10, § 3502(b)(2).

154. *Id.* See also *Fed Says Two Japanese Banks May Acquire U.S. Primary Dealers, Despite Trade Bill*, 20 Sec. Reg. & L. Rep. (BNA) 888 (June 10, 1988).

155. 20 Sec. Reg. & L. Rep. (BNA) 888 (June 10, 1988). It should be noted that while both banks did not meet the 5.5% minimum capital level, specified in the Federal Reserve Board's Capital Adequacy Guidelines, they were granted primary dealer status after the Board made adjustments for Japanese banking and accounting standards. *Id.* It appears that Sanwa, Long Term Credit Bank, and Industrial Bank of Japan will be allowed to continue their primary dealer status under the Act's grandfather acquisition provision. *New York Fed Adds Three Primary Dealers to List But Passes Over Japanese House*, 20 Sec. Reg. & L. Rep. (BNA) 1066 (July 8, 1988).

156. *Japanese Slow Investments in U.S. Markets*, L.A. Times, Nov. 7, 1987, pt. IV, at 2, col. 1.

157. It has been speculated whether transference of foreign capital out of United States

The Primary Dealer's Act takes the form of a final attempt to reduce the trade imbalance with protectionist policy. What the authors of the Act fail to remember is that the Japanese need the United States as much as the United States needs the Japanese.¹⁵⁸ The United States and Japanese financial markets are so closely related that they will become almost interdependent in the future.¹⁵⁹ So much so that the Japanese and United States will have to cooperate.¹⁶⁰ As Japan emerges as a leading world financial power it is unwise to unilaterally force reciprocity. A more effective solution could be derived from actual Japanese participation and cooperation.

IV. COOPERATION TO ELIMINATE RESTRICTIONS

In order to effectively eliminate Japanese restrictions on United States firms attempting to enter Japanese securities markets, the United States and Japan must commence negotiations aimed at reciprocity. An example of the resulting effectiveness of such negotiations is exemplified by the Japan-U.S. Agreement on Semiconductor Trade¹⁶¹ and the Japan-United States: Memorandum of the U.S. Securities Exchange Commission and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information.¹⁶² Both agreements have resulted from negotiations between the two countries which provide for implementation, verification, and enforcement.

The Agreement on Semiconductor Trade was developed as a result of complaints by the United States semiconductor industry that Japanese computer chip manufacturers were impeding United States semiconductor manufacturers' access to Japanese computer chip markets and that Japanese manufacturers were dumping semiconductors on world markets thus violating United States dumping laws.¹⁶³ By entering the agreement the United States semiconductor industry substantially increased its sales position in Japanese semiconductor mar-

financial markets was one cause of the recent market break on Black Monday, October 19, 1987. See *Volatility and Panic in the Nations Financial Markets: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 1st Sess. 49-50 (1987) (statement of David S. Ruder, Chairman, Securities and Exchange Commission).

158. Trade and Competitiveness Hearing, *supra* note 6, at 206.

159. *Id.*

160. *Id.*

161. Agreement on Semiconductor Trade, Sept. 2, 1986, United States-Japan, 25 I.L.M. 1408 [hereinafter Semiconductor Agreement].

162. May 23, 1986, 25 I.L.M. 1429 [hereinafter Japanese MOU].

163. Semiconductor Agreement, *supra* note 161, at 1408.

kets.¹⁶⁴ The agreement specifically provides for the establishment of an organization in Japan which will “provide sales assistance for foreign semiconductor producers as they attempt to penetrate Japanese markets.”¹⁶⁵ The agreement also provides for a monitoring of costs and prices of such products exported from Japan to the United States.¹⁶⁶ In the event that members of either countries’ semiconductor industry fail to comply, enforcement will be taken pursuant to the laws of Japan and the United States.¹⁶⁷ In addition, if either country breaches the agreement, a procedure for further negotiations is provided.¹⁶⁸

An alternative to such a formal treaty is a “memorandum of understanding” between the United States Securities and Exchange Commission and the Japanese Ministry of Finance. A memorandum of understanding is an agreement negotiated between The Commission and its counterpart in a foreign country.¹⁶⁹ To date, the Commission has only entered into four such agreements.¹⁷⁰ All of these agreements have been in the area of insider trading. One such agreement was entered into between the Commission and the Securities Bureau of the Japanese Ministry of Finance.¹⁷¹ The agreement recognizes the fact that the internationalization of securities markets has resulted in the trading of securities of one country upon the securities exchanges in the other.¹⁷² As a result, the agreement provides for a sharing of surveillance and investigatory information between the two

164. *Id.*

165. *Id.*

166. *Id.* at 1411.

167. *Id.*

168. *Id.*

169. Smith, *The Saga of MOU's*, N.Y.L.J., Apr. 28, 1988, at 5, col. 1.

170. *United Kingdom-United States: Memorandum of Understanding on Exchange of Information in Matters Relating to Securities and Futures*, Sept. 23, 1986, 25 I.L.M. 1431; *Japan-United States: Memorandum of the United States Securities and Exchange Commission and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information*, May 23, 1986, 25 I.L.M. 1429; *Switzerland-United States: Memorandum of Understanding to Establish Mutually Acceptable Means for Improving International Law Enforcement Cooperation in the Field of Insider Trading*, Aug. 31, 1982, 22 I.L.M. 1; *Canada-United States: Memorandum of Understanding on Exchange of Information*, Jan. 7, 1988, 27 I.L.M. 412. For a discussion of the United Kingdom, Japan, and Swiss memorandums, see Note, *Enforcing Securities Regulations Through Bilateral Agreements with the United Kingdom and Japan: An Interim Measure or a Solution*, 23 TEX. INT'L L. J. 251 (1988). For a discussion of the Switzerland-United States Memorandum, see Comment, 15 GA. J. INT'L & COMP. L. 135 (1985).

171. Japanese MOU, *supra* note 162.

172. *Id.* at 1429.

agencies.¹⁷³ While the agreement hardly provides specific requirements for the sharing of information, as do similar agreements,¹⁷⁴ it does establish a basis for cooperation.

Attempts by the United States and Japan to enter either a treaty or a memorandum of understanding would be a major step towards reducing the trade deficit and improving economic relations between the two countries. The benefits of entering a treaty or memorandum, rather than unilateral action, are compelling.

V. UNITED STATES-JAPAN: MEMORANDUM OF UNDERSTANDING TO ESTABLISH EQUAL ACCESS TO UNITED STATES AND JAPANESE SECURITIES MARKETS

In an effort to facilitate access of United States firms to Japanese securities markets, Japan and the United States must enter into an agreement similar to either the Semiconductor Agreement or one of the existing MOUs. The end result of either type of agreement would be the same. However, it would seem more logical for this agreement to be similar in form to the memorandum of understanding. The parties to such an agreement would be the United States Securities and Exchange Commission, the Board of Governors of the Federal Reserve, and the Japanese Ministry of Finance. The agreement would serve as a basis for eliminating Japanese restrictions on United States firms in Japanese securities markets and restrictions on Japanese firms in United States securities markets. The content of this agreement would address the four principle areas of unequal treatment discussed in this Comment, Japanese restrictions in terms of licensing,¹⁷⁵ limited exchange membership,¹⁷⁶ fixed commission rates,¹⁷⁷ and the government securities markets.¹⁷⁸

First, Japanese licensing requirements for United States firms would be totally abolished. Provisions of the agreement would set forth that the Securities and Exchange Commission and Ministry of Finance share information regarding a firm's status as a broker-dealer or licensed firm. The United States would grant broker-dealer status to Japanese firms in the United States so long as the firm had already been granted a license by the Japanese Ministry of Finance. Likewise,

173. *Id.*

174. *See supra* note 170.

175. *See supra* text accompanying notes 16-71.

176. *See supra* text accompanying notes 72-85.

177. *See supra* text accompanying notes 86-94.

178. *See supra* text accompanying notes 95-126.

Japan would grant licensed firm status to United States firms so long as the firm is, and continues to be, a registered broker-dealer. Of course, this would not eliminate the registrant/licensee's duties under the other securities laws, only the initial registration/license requirements. Final approval would be conditional upon certification of such status by the appropriate country's administrative body, the Securities Exchange Commission or the Ministry of Finance, and other specifics to be negotiated between the two agencies. Of course, in the event that status in the firm's home country is revoked, limited, or censured, their status in the other country would also.

Second, in the area of exchange membership, the agreement would provide that Japanese and United States securities exchanges grant reciprocal membership privileges. For instance, a United States firm, which is a member of the New York Stock Exchange, would only be granted membership on the Tokyo Stock Exchange if the New York Stock Exchange granted membership to a Japanese firm that was already a member of the Tokyo Stock Exchange. Of course, this would not only be prospective, but also retroactive to take into account current membership.

Third, in terms of brokerage commissions, the Japanese Ministry of Finance must agree to abolish fixed brokerage commission requirements. This would allow both United States and Japanese firms the ability to compete for Japanese clients by offering lower commissions. This provision would also be beneficial to existing Japanese firms because they would be able to compete with other Japanese firms for Japanese customers.

Lastly, the agreement would provide that the Japanese adopt a policy of national treatment regarding participation in the Japanese government bond market. Of course, the government securities markets of the two countries differ substantially. However, this provision of the memorandum would expand upon the underlying principles set forth in section 3502(4)(c) of the Primary Dealers Act. For example, so long as United States and Japanese firms are allowed the opportunity to obtain government securities of the other country in the primary market there would be no problem. However, if the Japanese bond syndicate actually prevented United States firms from participation in Japanese bond markets the Federal Reserve Bank of New York and the Securities and Exchange Commission would prevent Japanese firms in the United States from participation in both primary and secondary government securities markets.

Of course, the above suggested provisions are rather simplistic and would be difficult to negotiate with the Japanese because of the long history of such restrictions in the Japanese markets. But any attempt at bilateral elimination of such restrictions would be better than unilateral action.

The final result of such an agreement, addressing the above restrictions together or separately, hopefully, would be the elimination of restrictions on United States firms in Japanese securities markets. As a result of elimination of such restrictions, United States firms could obtain a large share of the Japanese securities markets causing an inflow of funds to the United States which could possibly offset the trade imbalance between the United States and Japan.

IV. CONCLUSION

Until an effective method of reducing the federal budget deficit is developed we must continue attempts to eliminate Japanese barriers to trade in order to reduce the United States trade deficit with Japan. While such barriers could be reduced in several industries, significant reductions in the United States trade deficit with Japan would occur if the Japanese eliminated restrictions in Japanese securities markets.

The key to eliminating barriers to Japanese securities markets does not rest upon a unilateral coercive form of reciprocity but upon mutual cooperation by both the United States and Japan.

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