Japanese ATS Regulation:
Its Development and Remaining Issues

Sadakazu Osaki

I. Regulation before 1998

An alternative trading system (ATS) is a means of matching orders from multiple market participants (including institutional investors and broker-dealers) to buy or sell securities such as equities and bonds using a computer network. The function carried out by an ATS is similar to that of a traditional stock exchange or organized OTC market. However, ATSs are regulated as broker-dealers, not as stock exchanges in many jurisdictions. Thus, institutional investors are able to participate directly in an ATS, instead of placing orders through broker-dealers which have membership in a stock exchange.

ATS was commonly known as a proprietary trading system (PTS) until recently. The U.S. Securities and Exchange Commission (SEC) formally referred to it as an ATS in their rule called Regulation ATS adopted in December 1998.1 The first example of a PTS (or an ATS) was Instinet (then called Institutional Network), which began life in 1969 in the United States. In the 1970s and 80s, Instinet and other PTSs were regulated as broker-dealers. SEC issued a number of no-action letters allowing PTS to operate without exchange registration required to stock exchanges under the Securities Exchange Act of 1934.2

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In Japan, on the other hand, operation of an ATS was effectively banned by a provision of the Securities and Exchange Law. Art. 87-2 (before the 1998 amendment) of the law prohibited the formation of an organized securities market similar to a stock exchange market. Anyone who carried out transactions on securities and securities derivatives utilizing such an organized securities market could face criminal sanctions. It seems that the original intention of the provision was to make it illegal for broker-dealers to hold organized auction sessions for listed stocks outside exchange markets. However, as a consequence, the provision ruled out the possibility of any attempt to operate a viable U.S.-style ATS in Japan.

Another regulation regarded as an obstacle to an ATS starting operation in Japan was the market concentration rule, or prohibition of off-exchange trading. Every stock exchange member had an obligation not to trade listed stocks outside its exchange with few exceptions, such as trading in another exchange market. Moreover, the interpretation of this rule by the Ministry of Finance, the regulator of Japanese securities markets at that time, was that the rule would be applied to non-exchange members as well. Therefore, if a broker-dealer operating an ATS received a buy or sell order for a listed stock, the firm should always send the order to a stock exchange member firm in accordance with the market concentration rule. However, it should be noted that it was unclear what sort of sanctions the non-member firm would face when acting in breach of a stock exchange rule such as the market concentration rule. Normally, exchange rules only apply to its members.

This situation changed completely when, as part of the “Big Bang” program of financial reform, the government decided to encourage competition between securities markets as a means of improving their efficiency and quality. Thus, prohibition of off-exchange trading was relaxed, and the operation of an ATS was legalized as one of the licensed activities of a broker-dealer.

II. ATS REGULATION AFTER THE “BIG BANG”

1. Removal of Ban on ATS

The Financial Systems Reform Law, which took effect in December 1998, made considerable amendments to the provisions of the Securities and Exchange Law governing market regulation. Art. 80 of the Securities and Exchange Law, as amended, provided that the formation of an organized securities market was only allowed for a stock exchange that had received a license from the prime minister. The operation of an OTC

4 For the whole picture of the reform, see H. Oda, The Reform of the Financial System in Japan: ZJapanR No. 6 (1998) 3.
securities market by a licensed securities dealers association was regarded as an exception. Artt. 2 and 167-2 of the Securities and Exchange Law provided that the rule prohibiting the formation of organized securities markets without a license would not be applied to anyone who had received permission to operate an ATS. 6

The lifting of this restriction on the operation of an ATS allowed broker-dealers to offer their customers an order-matching service that was previously, to all intents and purposes, monopolized by the stock exchanges and the OTC stock market operated by the Japan Securities Dealers Association (JSDA). This was an epoch-making development in that it allowed more scope for securities markets to compete against each other. Nevertheless, the operation of an ATS was still subject to major restrictions, and it was thought unlikely that the Japanese authorities would permit U.S.-style ATSs such as Electronic Communication Networks (ECNs) to become fully operative in Japan.

2. Restrictions on Price Discovery Mechanisms

The problem was that the law imposed severe restrictions concerning the price discovery mechanisms used by ATS. Under the Securities and Exchange Law (Art. 2 para. 8 no. 7), only three such mechanisms were allowed: (1) (in the case of listed securities) using the transaction price in stock exchange markets; (2) (in the case of securities registered on the OTC market operated by the JSDA) using the transaction price as published by the association; and (3) using a price based on negotiation between customers. In addition, an ATS was allowed “to use pricing mechanisms permitted by the prime minister’s office and Ministry of Finance orders.” However, no such orders were enacted immediately.

It was understood that (1) and (2) mentioned above referred to so-called crossing systems that match orders in accordance with closing or opening or other prices formed in stock exchanges. There are indeed crossing systems regulated as ATSs in U.S. and European markets. One example is the POSIT system operated by ITG Inc. (3) was intended to allow negotiation functions employed by Instinet and some other U.S. ATSs.

In June 2000 the first permissions under the new regime were granted to Japan Bond Trading Securities Company, the biggest inter-dealer broker in the Japanese government

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6 Neither the term ATS nor PTS is used in the law itself. Art. 2 para. 8 no. 7 says that “to make the sale or purchase of a security, or to act as a finder, broker, or agent for the sale or purchase of a security, through an electronic information processing system, by making use of a price formation method set forth below or any other method similar thereto, and either by bundling a large number of persons as a single trade party or by making the large number of persons as separate trade parties” is a part of “securities business.” Japanese Financial Services Agency (FSA), which regulates securities markets, formally uses the term PTS. However, in this paper, the author consistently uses the term ATS to address electronic trading systems other than traditional stock exchanges.
bond market, and E Bond Securities. The former system was to trade major listed and OTC stocks outside normal exchange trading hours and anticipated wide participation of institutions and broker-dealers. On the other hand, E Bond Securities, a newly formed joint venture between Softbank Corporation and Lehman Brothers, intended to trade illiquid securities such as corporate and regional government bonds.

As a result of the restriction explained above, the two systems granted permissions by the Financial Supervisory Agency (as it was then) were both required to use prices based on negotiation between their customers. In order to maintain the appearance that prices were negotiated, however, they had to resort to the absurd device of not allowing orders to be matched automatically, even if there were sell and buy customer orders bearing the same price and quantity. Naturally, this arrangement was not welcomed by the investment community. Both systems experienced difficulty in acquiring a critical mass of participants.

The restriction was based on the idea that an ATS should not have the same degree of price discovery function as the organized securities markets defined in the Securities and Exchange Law (i.e., existing stock exchanges and the JSDA’s OTC stock market). It was assumed that if ATSs were to allow free formation of prices, it would disrupt fair and orderly markets maintained by stock exchanges and the JSDA. The Operational Guidelines published by the FSA made clear that “no proprietary trading system should be allowed to have the same degree of price discovery function as a stock exchange” and that the granting of a license to operate such a system “should be conditional on its pricing mechanism not having the same degree of price discovery function as that of a stock exchange” (Art. 3-1-3 of the Operational Guidelines).

3. Further Restriction Imposed by May 2000 Revision

Furthermore, the May 2000 revision to the Securities and Exchange Law, which permitted stock exchanges to demutualize, also contained a provision that can be interpreted as further restricting the pricing mechanisms available to an ATS.

As a result of this revision, the licensing requirement for stock exchanges was repealed. Instead, a licensing requirement for securities markets was introduced. Both traditional stock exchanges formed as a membership organization (securities membership organization) and newly established or demutualized exchanges formed as joint stock companies (kabushiki kaisha) were required to obtain licenses to operate organized securities market. On the other hand, a broker-dealer operating an ATS under the

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permission granted by the FSA was exempted from the obligation “to have a license from the Financial Reconstruction Commission in order to establish a securities market” (Art. 80 para. 2 no. 2 Securities and Exchange Law). At first glance, this seems to be a reasonable approach.

At the same time, however, the article stated that this exemption would not apply in cases where the transaction price was to be decided “by auction or other mechanisms stipulated by a Cabinet Order.” Here an “auction”-based trading system is taken to mean the itayose (call auction) and zaraba (continuous trading of limit and market orders), price formation methods used by the Tokyo Stock Exchange as defined in the pre-war Exchange Law and related explanatory materials.

Consequently, an ATS was to be prevented from adopting pricing mechanisms employed in existing stock exchanges and other methods that could be considered as an auction. If the mechanism adopted by an ATS was regarded to be “auction,” the ATS would be required to transform itself into a stock exchange. Although the new law allowed the existence of stock exchanges formed as joint stock companies, they would be subject to strict regulations governing their shareholder structure and barred from engaging in other business areas. For instance, no single entity may own or obtain over 5% of the total outstanding stock issued by an exchange formed as a joint stock company (Art. 103 Securities and Exchange Law). Therefore, business plans and corporate structure of an ATS would be heavily affected if it chose to transform itself into a stock exchange.

III. NEW GUIDELINES ON ATS REGULATION

1. Expansion of Price Discovery Mechanisms

In December 2000 a set of Financial Services Agency guidelines on operating an ATS was enacted together with a related Cabinet order and a set of administrative guidelines, thereby enabling an ATS to use two price discovery mechanisms in addition to those that had already been statutorily approved: (1) using customer limit orders to match transactions and (2) using multiple price quotations by securities companies (Art. 8-2 Cabinet Order on Definitions of the Wordings in the Securities and Exchange Law9).

The former of two new methods for price discovery is defined as “the mechanism whereby a customer’s price limits are used where they match those of another customer appearing as the counterparty.” In other words, a customer’s limit orders are matched with those of other customers. This might appear similar to the itayose and zaraba methods used on Japanese stock exchanges (i.e., the “auction” method defined in Art. 80

para. 2 no. 2 Securities and Exchange Law). Nevertheless, it is actually very different in that market orders are not allowed.

Allowing this pricing mechanism did away with the absurd need to immobilize an automatic order-matching system in order to maintain the appearance that prices were negotiated among customers. The opportunities for ATSs to improve their efficiency emerged. Under this new provision, most of the U.S. ATSs such as ECNs may be able to operate as Japanese ATSs if they impose the additional restriction of prohibiting market orders.

The latter method is defined as ‘the mechanism whereby prices are based on securities dealers’ bid and offer price indications (‘quotes’), which may be either their own or those of other dealers, for the same security. (This excludes cases where a number of dealers are obliged to give bid and offer indications on a continuous basis and where prices are based on these.)’

In other words, this is the case when a number of broker-dealers use an ATS to make a market in a particular security and act as a counter-party when executing customer orders. At first glance, this seems to be a competitive market-maker system adopted in the U.S. NASDAQ market and in trading of some stocks in the JSDA OTC stock market.

However, the FSA emphasizes a difference between this method allowed for an ATS and the competitive market-maker system employed in organized markets. According to the FSA, specific dealers continuously make prices in accordance with a clearly defined set of rules and are obliged to execute orders in specific lot sizes in the JSDA OTC stock market. Therefore, it should be regulated as an organized securities market with licensing requirement. Lacking this kind of strict rules, an ATS can operate in a manner somewhat similar to competitive market-maker systems without a license as a stock exchange or a securities dealers association.

2. Clarification of the Terms Used in Regulation

The new guidelines therefore allow Japanese ATSs to use a wider range of price discovery mechanisms than before. However, the fact that Art. 200 para. 1 of the Securities and Exchange Law imposes penalties for broker-dealers that operate an ATS without permission means that any broker-dealer operating a computer system as part of its securities business needs to know exactly when such permission is not required. Otherwise, it is likely to run into trouble. For example, a broker-dealer displaying several quotes on its system is considered to be an ATS using the price indication method. However, it may be unclear whether a broker-dealer that is the only market-maker in a security and executes a customer order in accordance with its displaying quote on its computer system would be regarded as an ATS or not.

One possibility for resolving this type of issue is to provide a no-action letter confirming that a particular system did not require approval. It is the approach adopted by
the U.S. SEC in the early days of PTSs. However, the Japanese FSA decided that the best way to clarify the situation was to include the following clauses in the revised Operational Guidelines (Art. 3-1-3 (1) Operational Guidelines):

“(1) Systems that transmit orders for securities traded on stock exchanges or OTC stock markets, or that transmit orders to another broker-dealer shall not be considered to be ATSs or stock exchange markets.

(2) Systems where prices are based on quotes and which pool the supply and demand of securities by means of multiple orders may be considered to be ATSs or stock exchange markets if the broker-dealer concerned adjusts his own price indications to his customers’ orders.”

(1) refers to a mechanism for collecting orders by means of a computer system, such as an Internet-based system operated by securities brokers for individual investors. It will be unreasonable if these online brokers are all regarded as operating ATSs. On the other hand, “[s]ystems that transmit orders to another stockbroker” probably refers to a mechanism for transmitting orders from a broker-dealer that is not a member of an exchange to one that is, or to a broker-dealer that is acting as a market maker off-exchange. This type of system is a so-called order-routing system, and it also should not be regulated as a trading system. Presumably, if a system is designed to route orders to several broker-dealers indicating quotes, it may be regulated as an ATS using the price indication method.

(2) probably refers to a rather special situation where a broker-dealer makes a market on its own. Normally, a broker-dealer that makes a market would be expected to adjust its quotes to the flow of orders from its customers and its own position. However, if a broker-dealer waits until its customer orders balance out before making a quote (based on the prices customers are prepared to pay), it is, to all intents and purposes, simply matching customer orders. This provision in the Operational Guidelines is designed to ensure that a broker-dealer doing this seeks to have it approved as an ATS. This also means that a broker-dealer making a market on its own in the normal way (and therefore not matching customer orders) is not required to have its computer system approved as an ATS.

The above discussion can be summarized in the following table:
**Table 1: Price Discovery Mechanisms and Regulatory Status**

<table>
<thead>
<tr>
<th></th>
<th>Order-driven methods</th>
<th>Quote-driven methods</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Organized securities market</strong></td>
<td>Call (<em>itayose</em>) and continuous (<em>zaraba</em>) auctions on a stock exchange that permit limit and market orders (auction method)</td>
<td>A number of market makers make continuous prices on the OTC stock market</td>
<td></td>
</tr>
<tr>
<td><strong>Alternative trading system</strong></td>
<td>- Order matching using limit orders only (order-matching method) - Customers negotiate their own prices with other customers (customer-negotiated prices)</td>
<td>A number of market makers make prices (price indication method) A single market maker collects customer orders on its trading system and makes prices accordingly</td>
<td>Trades are crossed using prices from a stock exchange or the OTC stock market (market-price trading)</td>
</tr>
<tr>
<td><strong>Normal broker-dealer activities</strong></td>
<td>Broker-dealers trading on their own account act as counterparty in response to customers’ limit orders Broker-dealers forward orders to a securities market or another broker-dealer</td>
<td>A single market maker makes prices</td>
<td></td>
</tr>
</tbody>
</table>

One activity that is often difficult to distinguish from the operation of an ATS is the posting of price indications by an information vendor on its terminals. In fact, a significant amount of bonds and CPs and other instruments are traded with the help of indications posted on Bloomberg and Reuters, without being regulated as ATSs. It is because these activities by information vendors do not directly involve facilities for carrying out actual transactions.

Here the guidelines have tried to make the position clearer by responding to some of the comments made during the process of public consultation: “In our view, in cases where quotes posted by more than one broker-dealer are visible simultaneously (i.e., where there are competing quotes) and where the means necessary to reach an agreement on the terms of a transaction such as provision of proprietary terminals or links for placing orders and negotiating are provided, the activity should be considered to be ‘intermediation’ as defined in the Securities and Exchange Law and permission should be sought to operate an ATS.” In such a case, the computer system should be considered to be an ATS (that uses the price indication method for price discovery) rather than a simple financial information system.
3. Prevention of Unfair Trading Through ATS

In addition to the conditions related to price discovery mechanisms, the previous Operational Guidelines attached the following conditions to granting permission to an ATS: (1) the person in charge of the system had to have at least five years’ experience in the securities industry, and there had to be a proper organizational structure and sufficient staff to operate the system; (2) there had to be a procedure for checking customer identities; and (3) there had to be a way of preventing unfair or illegal practices such as insider dealing.

The new guidelines lay down detailed provisions for ensuring fair and orderly operation of an ATS: (1) explaining to customers matters such as how prices are determined, how settlement failures will be dealt with, and the likelihood of a transaction being concluded at the price indicated; (2) ensuring that systems are secure and provide the necessary capacity to absorb all the orders (e.g., by backing up and testing systems); and (3) taking preventive action to ensure that transaction data remain confidential by establishing firewalls between staff operating an ATS and other staff belonging to different sections of the broker-dealer (Art. 3-1-3 (2) (ii) and following provisions of the Operational Guidelines). Also, the Cabinet Order now requires broker-dealers to publish monthly reports on the volume of trade conducted on their ATSs as well as keeping a record of all transactions (Art. 33 para. 2 no. 2 and Art. 60 para. 1 no.14 of the Cabinet Order on Broker-Dealer Firms\(^{10}\)).

Furthermore, the new guidelines imposed an additional obligation on broker-dealers to make their prices and other details of transactions concluded on their ATS publicly available in order to ensure fair and orderly trading of securities. In particular, the guidelines require broker-dealers to “make their best bids and best asks and actual transaction prices readily accessible in real time to outsiders in such a way that they can be compared with those of other ATSs.”

In the U.S. markets, quotes and transaction information over the ECNs are disseminated publicly through the NASDAQ system. Information on listed stocks is also disseminated through Computer Assisted Execution System (CAES) and its link with Intermarket Trading System (ITS) which is an important part of National Market System (NMS).

On the other hand, the Japanese market does not have any system infrastructure enabling information on off-exchange transactions to be disseminated to the public on a real-time basis. According to the JSDA rule on off-exchange transactions (Fair Practice Rule No.5\(^{11}\)), every transaction should be reported within five minutes in principle after


As trading of listed securities through ATSs will be regarded as off-exchange transactions, broker-dealers operating ATSs are subject to this obligation. The rule provides that the JSDA should promptly make reported information publicly available. However, this is not in real-time basis, and more importantly, the reporting obligation does not cover pre-trade information such as best bids and asks quoted by broker-dealers including ATSs.

The Operational Guidelines therefore only require that “best bids and asks, transaction prices and other sort of data be readily accessible to outsiders until such time as they can be made available in a form that enables them to be compared with those of other ATSs.” Although there is some significance in the fact that the FSA Guidelines require publication of quote information which is not covered by the existing JSDA rule, it is far from consolidating information with regard to traded securities. The rule suggests, for the time being, that it will be sufficient for a broker-dealer operating an ATS to display the necessary data on its Web sites or on screens of terminals provided by information vendors, even if they cannot be directly compared with those of other ATSs or stock exchanges.

Moreover, this requirement that broker-dealers operating an ATS make quotes and price data publicly available applies only to systems used for trading equities and convertible bonds, not to systems used for trading government and corporate bonds. This exemption was probably granted in view of the sheer number of such bond issues and the technical difficulty of making data available on all of them, and the nature of bond trading (i.e., the fact that it is relatively easy to judge what is a reasonable price for a bond from the market interest rates and the issuer’s credit rating).

An ATS is operated by a broker-dealer, not by a stock exchange or a securities dealers association recognized as a self-regulatory organization under the Securities and Exchange Law. Therefore, it is not obliged to carry out regulatory functions such as monitoring of market activities and the supervision of market participants. However, activities on an ATS may be a matter of concern from the public-interest viewpoint, if trading on it becomes more active and if either the number of market participants increases or volume expands significantly.

In the United States, Regulation ATS imposes stricter requirements, such as an obligation to ensure fair access of participants to maintain a high degree of capacity, integrity, and security of automated systems in the case of ATSs that handle certain trading volume. Moreover, if an ATS handles 50% or more of the average daily dollar trading volume in any security and 5% or more in any class of securities, the ATS should register with the SEC as an exchange under the 1934 Act.

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13 See Rule 301 (b), 17 CFR Ch. II, § 242.301.
14 SEC Rule 3a1-1 (b) (1), 17 CFR Ch. II, § 240.3a1-1.
The new Operational Guidelines issued by the FSA, similarly, require ATSs that handle more than a certain amount of trading volume in a listed or an OTC-registered stock to comply with the same requirements as an organized securities market (e.g., to obtain a license to set up a securities market, to monitor trading, and to set aside reserves for penalties or losses).

More specifically, the guidelines require an ATS that handles 10% or more of trading in a particular stock in relation to the combined average daily trading volume on the Tokyo, Osaka, and Nagoya Stock Exchanges and the OTC stock market over the past six months or 5% of total volume on these markets to strengthen its monitoring and screening of market activities, and to set aside reserves for possible penalties or losses. Similarly, the guidelines require a broker-dealer operating an ATS that handles 20% or more of trading volume in a particular stock or 5% of total volume on the above markets to obtain a license to set up a securities market.

As with the requirements to make quotation and price data available to the public, these volume criteria apply only to ATSs that trade equities and convertible bonds, not to those that trade government and corporate bonds. Given that the bulk of bond trading is done on the OTC market (even in the case of bonds listed on exchanges), it would have been inappropriate to take volume on an exchange as the criterion for deciding the level of regulation.

IV. REMAINING ISSUES

Since January 2001, six additional PTSs for trading bonds and equities have received permissions from the FSA under the new guidelines.

Table 2: ATGs Received Permission in 2001

<table>
<thead>
<tr>
<th>Date of Permission</th>
<th>Broker-Dealer Firm</th>
<th>Traded Securities</th>
<th>Method of Price Discovery</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 19</td>
<td>MTS Japan</td>
<td>JGB</td>
<td>Price Indication Method</td>
</tr>
<tr>
<td>January 19</td>
<td>Garban Totan</td>
<td>JGB</td>
<td>Order-Matching Method</td>
</tr>
<tr>
<td>January 26</td>
<td>Monex</td>
<td>Listed and OTC Stock</td>
<td>Market-Price Trading</td>
</tr>
<tr>
<td>January 26</td>
<td>Instinet</td>
<td>Listed and OTC Stock</td>
<td>Order-Matching Method</td>
</tr>
<tr>
<td>February 19</td>
<td>Japan Bond Trading</td>
<td>Bond</td>
<td>Order-Matching Method</td>
</tr>
<tr>
<td>February 19</td>
<td>Cantor Fitzgerald</td>
<td>Bond</td>
<td>Order-Matching Method</td>
</tr>
</tbody>
</table>
Although considerable progress on the issue of how ATSs should be regulated has been achieved in a short time, we should admit that a number of major issues remain unresolved.

First, it is difficult to justify why an ATS should be regarded as an inferior means of price discovery to an organized securities market operated by a stock exchange or a securities dealers association. While the more public status of stock exchanges and the need to protect investors may well require that they be subject to rigorous regulation, there is no good reason why particular price discovery mechanisms should be preserved for stock exchanges or the OTC stock market operated by the JSDA.

In the United States, trading systems with a similar function to stock exchanges are regarded as ATSs, and the degree of regulation to which they are subject depends on the level of trading volume rather than the particular price discovery mechanism used, as discussed above. Also, even a stock exchange (with its obligation to meet certain self-regulatory standards) may be exempted from the need to register with the SEC in order to lighten its regulatory burden if trading volume is exceptionally low.\(^\text{15}\)

In Japan, on the other hand, the December 2000 revision to the Securities and Exchange Law, which permits the demutualization of stock exchanges, can also be interpreted as restricting competition. The fact that a demutualized stock exchange is subject to more restrictions than an ATS (e.g., restrictions on diversification of business and a 5% limit on shareholdings), as has already been discussed, makes it very difficult for an ATS to become a stock exchange. As a result, Japanese law makes it difficult for trading systems that use the same price discovery mechanisms as existing stock exchanges to compete and can be said to shield the latter from competition.

Second, as inter-market competition increases and more ATSs trade the same security, the need to prevent market fragmentation by consolidating trading information and quotation information will also increase. In the United States, the National Market System (NMS) has been proposed as a means of providing the necessary infrastructure for this, and a number of sub-systems, including a consolidated quotation system (CQS), are up and running. Similarly, the NASDAQ consolidates and reports quotation data from ECNs trading mainly NASDAQ shares.

In its guidelines, the Japanese FSA permits ATS operators to report trading information on their Web sites until it is possible to do this centrally. In the medium to long term, however, some system solution is required.

Third, as it becomes possible to execute orders on more than one market (stock exchange, proprietary trading system, etc.), it will become necessary to impose certain requirements on how broker-dealers deal with client orders (especially those from retail investors) to ensure that investors are sufficiently protected. In the United States, broker-dealers are, in principle, subject to a “best execution obligation,” which is under-

\(^{15}\) Art. 5 para. 2 Securities Exchange Act of 1934. Arizona Stock Exchange and Tradepoint have been granted the exemption by the SEC under the provision.
stood to oblige them to execute a client order on the best terms if the order can be executed on a number of markets or systems. Although the meaning of best execution is not completely clear, the principle may help investors who feel that they are unfairly treated by broker-dealers.

In Japan, on the other hand, this notion is not very well established. Until recently, the Securities and Exchange Law protected investors’ rights by prohibiting activities such as “bucketing.” However, these rules assumed that client orders would normally be routed to a stock exchange, and are not really suitable for a situation where several alternatives for executing an order – including ATSs – exist. Rules will therefore have to be devised for handling client orders and explaining the situation to clients, drawing, for example, on U.S. experience of the SEC’s order-handling rule.

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