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These articles in [Business Lawyers](#) have been re-edited and translated.

Part 1 What is Finance Law?

- Collaboration between Finance and Law

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Series Overview – 5 in total

- Part 1: What is Finance Law?
- Part 2: What is Corporate Finance?
- Part 3: What is Structured Finance / Asset Finance?
- Part 4: What is Asset Management?
- Part 5: Financial Regulation Law

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1. Introduction upon serialization

This 5 part series is a digest of my book "Finance Law - Fundamentals of Finance Law and Essentials of Advanced Financial Transactions" (Shoji Homu, 2016). It is a book that summarizes the whole of finance law and practice as handled by major law firms and at the forefront of financial practice, in a single book. On the other hand, due to the use of numerous charts and tables, and from the perspective of comprehensiveness and accuracy, it is a large volume of more than 600 pages. This series summarizes the basics of Finance Law in a volume that is easy to read for beginners, and serves as an introduction to the Book.

The series divides the Book into 5 parts, and explains the following themes: "Part 1: What is Finance Law? - Collaboration between Finance and Law", "Part 2: What is Corporate Finance?" – in light of the distinction between Debt and Equity", "Part 3: What is Structured Finance/Asset Finance? - Financing using Funds/SPVs", "Part 4: What is Asset Management? - The world of Asset Management and Investment", and "Part 5: Financial Regulation Law – The world called Regulation."

2. What is Finance Law?

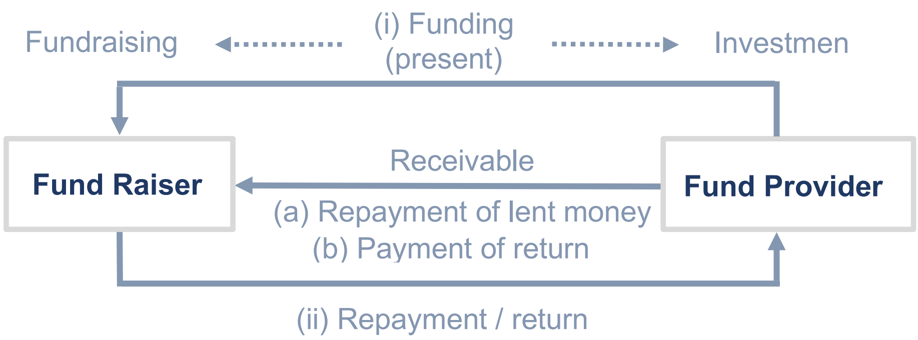
Finance Law is a general term to cover the various laws, regulations, and legal theories and practices that govern or relate to Finance, as well as related areas of Financial Economics. Since Japan does not have any statutory law named "Finance Law" nor any basic law governing a broad spectrum of Finance, the meaning and scope of "Finance Law" is influenced by the meaning and scope of "Finance" from the perspective of Financial Economics.

3. What is Finance?

3-1. Traditional and modern significance

The most basic element of "Finance" is the providing of funds by a fund provider (lender) to a fund raiser (borrower) which is financing for the fund raiser and is an investment for the fund provider (Chart 1-1).

【Chart 1-1: What is Finance?】



In Financial Economics and legal practice in Finance, (1) areas centered on fundraising (Corporate Finance, etc.: Part 2 and 3 of this series) and (2) areas centered on investment (Securities Investment Theory and Asset Management business: Part 4 of this series) are separate areas of specialization. This is because although fundraising and investment are ultimately a series of events, the economic theories and Financial Regulations required or related to each are different.

In addition, since there are various financial transactions other than the accommodation of funds (financing by sales and purchase of assets, Derivatives, etc.) in modern times, it is necessary to examine the modern significance of Finance including these. For the modern significance of Finance, for example, it is explained that risk and profit are the essential elements, or that it is an exchange of cash flows that have the same present value.

3-2. The essential elements of Finance

Finance (transactions) has two essential elements: intertemporal loans transactions without risk and risk-bearing transactions.

(1) Intertemporal loan transactions without risk (Time value of money)

Since money has time value, the fund provider (lender, shareholder, etc.) receives a rent/usage fee of money from the fund raiser (borrower, stock company, etc.). Such a rent/usage fee is called a **Risk-Free Rate** because it is calculated independently of the risk described in (2) below.

(2) Risk-bearing transactions (Risk premiums, etc.)

The risk borne by an investor (fund provider) that the funds will not be repaid by a fund raiser is called **Credit Risk**, and in return for bearing this, the investor receives a **Risk Premium** from the fund raiser. As a result, the sum of (i) the Risk-Free Rate and (ii) the Risk Premium is the minimum amount of return demanded by the investor. In addition, in Finance, Market Risk due to fluctuations in market prices also affects the value of a financial transaction.

3-3. Rights and obligations in Finance: Debt and Equity

The relationship of rights and obligations regarding risks between fund providers and fund raisers differs significantly between loans/deposits and stocks.

(1) Loans and deposits: Debt

The fund provider (lender or depositor) acquires a **definitive claim** against the fund raiser (borrower or bank) to repay the funds provided (principal) and pay a fixed return (interest) in a fixed amount on a fixed date. This type of claim is generally referred to as **Debt** (Part 2 of this series).

(2) Shares: Equity

The fund provider (e.g., shareholders) can demand the payment of a return (dividend) on the funds (investment) from the fund raiser (e.g., a stock company), but the fund provider cannot demand the payment at a certain date and in a certain amount. Whether or when the payment is made will be affected by the performance of the fund raiser and many other factors. This type of claim can be said as a **conditional claim**, in the economic sense, and is generally referred to as **Equity** (Part 2 of series).

(3) Relationships between Debt/Equity and Claims/Debts

In financing for the purpose of funding, investors are generally in the position of creditors and the fund raiser is in the position of debtor. In the case of monetary claim, the creditor has a right to demand payment of money (monetary claim) from the debtor, and if the debtor fails to perform the claim, the debtor is in default.

A **debt claims** is a typical example of a claim in the legal sense. In contrast, in case of an **equity claim**, a fund raiser (a stock company) does not have a definitive obligation to pay any money to fund providers (shareholders) unless certain conditions are met.

Therefore, an **equity claim** is a conditional claim, in the economic sense, where no specific and concrete claim arises until certain conditions are met.

4. Various types of Finance Transactions and their classification

4-1. General classification

There are various general classifications of financial transactions. However, the concept underlying each classification and the relationship between each classification are not necessarily unequivocal (for more details, see Chapter 2, Section 1 of the Book).

(1) Classification based on Financial Institutions

This method explains traditional financial transactions by Financial Institutions that conduct those transactions (e.g., banks → loans, securities firms → broker/dealer business, insurance companies → insurance business), and then explains advanced finance transactions (e.g., securitization, derivatives, etc.) in addition to traditional financial transactions and separately.

(2) Classification based on Direct and Indirect Finance

This method explains based on the distinction between financing through **Direct Finance** (a method where the fund raiser raises funds directly from the fund provider through the issuance of Securities or other instruments in the market) such as shares and bonds, and financing though **Indirect Finance** (a method where the final fund raiser raises funds indirectly from the final fund provider through an Indirect Financial Institution such as a bank) (e.g. loans) .

(3) Classification based on Debt and Equity

This is an explanation method based on the distinction between **Equity Finance** (financing with Equity) and **Debt Finance** (financing with Debt). In practice, there are many hybrids or intermediate types.

(4) Other classifications

In addition to the above, there are other concepts such as Corporate Finance, Asset Finance, Non-Recourse Finance, and Structured Finance.

(i) Corporate Finance

The term “Corporate Finance” is used in multiple senses: (1) financial transactions in general (broadly defined) from the perspective of a company, (2) financing based on the creditworthiness of a company (narrow sense) and (3) Debt Finance based on the creditworthiness of the company (narrowest sense). (1) above corresponds to **Corporate Finance in Financial Economics** (for more details, see Part 2 of this series).

(ii) Asset Finance, Non-Recourse Finance, Structured Finance

Asset Finance, Non-Recourse Finance and Structured Finance are methods used to deal with the disadvantages of Corporate Finance (for more details, see Part 3 of this series).

4-2. Classification based on the author’s personal opinion (An interpretation)

In my opinion, it is useful to classify financial transactions into the following four categories (or a combination of these) according to their purpose and risks. (for more details, see Chapter2, Sections 2 and 3 of the Book).

(1) Credit Transactions

It refers to a transaction that involves the Credit Risk (principal risk) of the fund raiser for the purpose of raising funds, which is conducted for investment (namely receipt of return) for the fund provider, and is conducted for the purpose of raising funds for the fund raiser. (Part 2 – Part 4 of this series).

(2) Sales transactions (Sale of assets for the purpose of funding)

Sales transactions (asset sales) conducted by the fund raiser for the purpose of raising funds (for more details, see Chapter 8, Section 1 of the Book).

(3) Derivative transactions

Derivative transactions conducted for hedging/speculative purposes mainly in order to trade market risks (for more details, see Chapter 10 of the Book).

(4) Fee Business

Transaction and services related to various types of financial transactions, which are conducted for the purpose of receiving fees (for more details, see Chapter 11 of the Book).

5. Significance and characteristics of Finance Law

5-1. Classification of Finance Law: Financial Transaction Law and Financial Regulation Law

Finance law is generally classified into two categories: **Financial Transaction Laws** (Part 2 - Part 4 of this series) and **Financial Regulation Law** (Part 5 of this series).

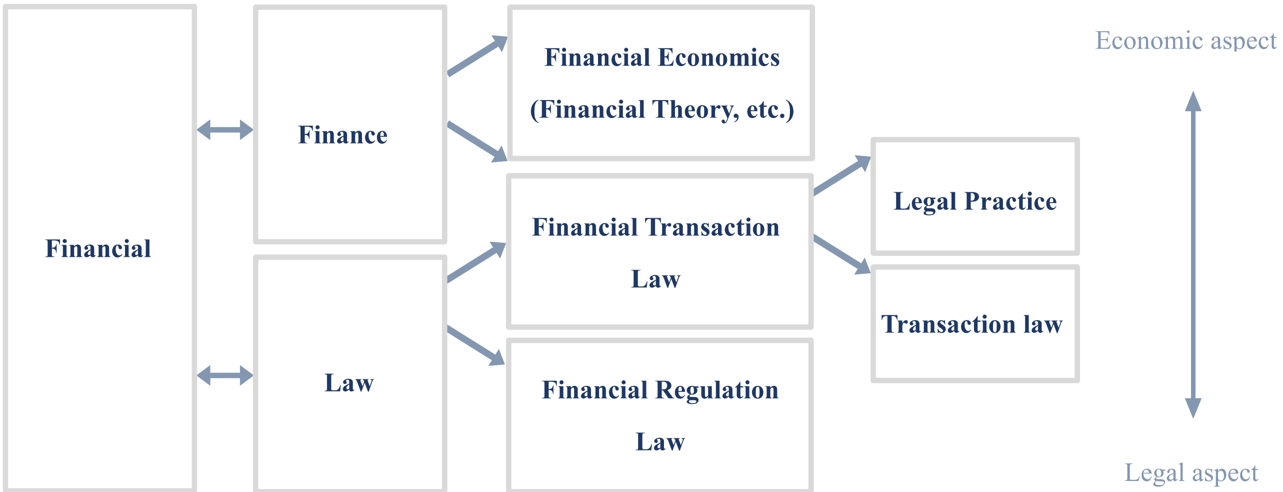
5-2. Relationship between Finance Law and Finance (Financial Economics)

As Finance Law is a field related to both Finance and law, some aspects of Financial Economics (Traditional Financial Theory and Modern Finance Theory) are inseparable from or serve as premises of Finance Law (Financial Transaction Laws and Financial Regulation Law).

When Financial Economics, Financial Regulation Law and Financial Transaction Law are compared, it can be said that (i) **Financial Economics** is the most economics-oriented field, and (ii) **Financial Regulation Law** is the most jurisprudence-oriented field among these three, where the details of individual financial regulations (interpretation of statutory articles) are often handled by legal scholars or practitioners (lawyers) specializing in Finance Law who play a central role in this area, and(iii) **Financial Transaction Law** is an intermediary field in where economics and jurisprudence are inseparably intertwined, as business entities conducting financial transactions propose their desired economic objectives and transaction details, and the role of Financial Law practitioners (lawyers) is to provide legal services to achieve them.

Furthermore, Financial Transaction Laws is (1) a more jurisprudence-oriented field **when viewed from substantive or procedural law perspective**, such as from the perspective of constituting a type of contract under the Civil Code or a litigation skill for attack and defense in litigation (referred to as **Finance Transaction Law** in the Book), and (2) a more economics-oriented field **when viewed from the perspective of dynamically utilizing legal theory in order to achieve the economic objectives desired by business entities** (referred to as **Legal Practice in Finance (Transaction)** in the Book).【Chart 1-2】summarizes the above.

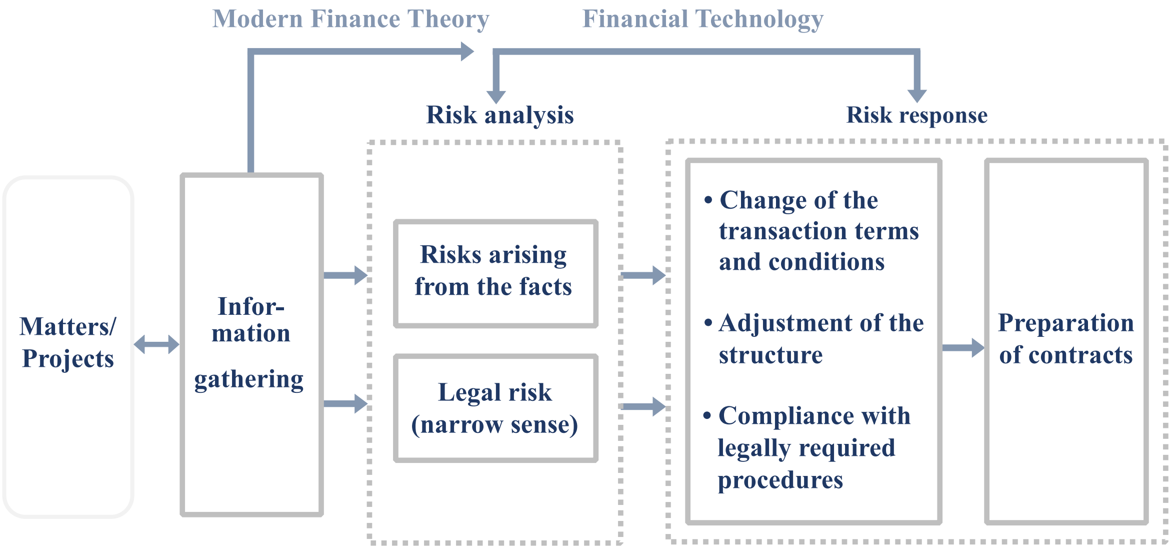
【Chart 1-2: Image of Finance Law (as a whole)】



5-3. Characteristics of Legal Practice in Finance

In legal practice in Finance, Finance and law are (i) fundamentally related to motive (purpose) and means, (ii) when there is a discrepancy or divergence between the intended financing transaction and the commonly used financing transaction (means), the risks associated with such discrepancy or divergence should be analyzed and verified, and the transaction structure itself should be modified, changed or created to resolve such discrepancies or gaps. In legal practice in Finance as above, (1) **Preventive Legal Practice** (legal practice that respond from the perspective of preventing or avoiding the occurrence of disputes or damage), (2) **Modern Finance Theory** (the field called Securities Investment Theory/Investment Theory and Corporate Finance in economics) , (3) **Financial Technology** (technology based on financial engineering developed against the backdrop of the development of information technology), and (4) **Unbundling** (dissecting investment risks or financial intermediation functions) are important concepts.【Chart 1-3】summarizes the above (for more details, see Chapter 3, Sections 2 through-5 of the Book).

【Chart 1-3: Image of risk analysis and response in preventive legal practice】



As this is the first part, I have outlined the significance and role of finance law. In the next part, I will provide a more detailed explanation focusing on corporate finance.