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Banking Regulation

Japan
Law & Practice

Atsushi Sakai, Ohki Mizuno and Hideaki Suda
Nagashima Ohno & Tsunematsu

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Law and Practice

Contributed by:
Atsushi Sakai, Ohki Mizuno and Hideaki Suda
Nagashima Ohno & Tsunematsu ***see p.13***

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1. Legislative Framework

1.1 Key Laws and Regulations

Principal Laws and Regulations

Banking Act

The principal laws and regulations governing the banking sector are the Banking Act (Act No. 59 of 1981) and the subordinate regulations enacted thereunder, including the Order for Enforcement of the Banking Act (Cabinet Order No. 40 of 1982) and the Regulation for Enforcement of the Banking Act (Ministry of Finance Order No. 10 of 1982).

The Banking Act defines banking as the business of conducting both acceptance of deposits and lending of funds, or providing money transfer services. Any person wishing to engage in banking must obtain a licence and will be subject to regulations under the Banking Act, including:

- restrictions on the scope of business by banks;
- restrictions on the scope of business by banks' subsidiaries;
- code of conduct;
- governance requirements;
- capital adequacy requirements;
- accounting (including disclosure requirements);
- regulations on major shareholders of banks; and
- regulations on bank holding companies.

The purpose of these regulations under the Banking Act is to "preserve the credibility of banking services in view of their public nature; to achieve the sound and appropriate management of banking services in order to ensure protection for depositors and facilitate the smooth functioning of financial services; and to thereby contribute to the sound development of the national economy" (Article 1 of the Banking Act).

Financial Instruments and Exchange Act

Contrary to "universal banks" in Europe, banks in Japan are generally prohibited from engaging in securities business, but this prohibition has gradually been relaxed, and the scope of securities business that banks are allowed to conduct has gradually been expanded. Banks can also conduct certain securities business through their subsidiaries. Securities business (whether conducted by banks themselves or through their subsidiaries) is regulated by the Financial Instruments and Exchange Act (Act No. 25 of 1948).

Regulators

Financial Services Agency

The principal regulator of the banking sector is the Financial Services Agency (FSA), which is authorised under the Banking Act to supervise banks. The authority of the FSA includes:

- conducting on-site inspections and off-site monitoring;
- issuing reporting orders, business improvement orders or business suspension orders; and
- revoking banking licences.

The FSA issues supervisory guidelines on the interpretation of laws and regulations. Historically, the FSA also issued an inspection manual to be used as a checklist in its on-site inspections, but this manual was abolished in 2019 in an effort to transform the FSA's supervisory approaches into more substantive, forward-looking and holistic analysis and judgment. The FSA has instead issued certain principles and theme-specific reports to announce its supervisory policies.

The FSA also has authority under the Financial Instruments and Exchange Act to supervise securities business conducted by banks or their subsidiaries. A portion of the FSA's authority to conduct inspections of securities business is delegated to the Securities and Exchange Surveillance Commission.

Bank of Japan

The Bank of Japan (BOJ) is the central bank of Japan. It does not have regulatory authority under the Banking Act, but it has a right to conduct on-site examinations of banks under the agreements that it enters into with the banks when opening accounts for such banks.

2. Authorisation

2.1 Licences and Application Process

Banking Licences

The Banking Act defines banking as the business of conducting both acceptance of deposits (including installment savings) and lending of funds (including discounting of bills and notes), or providing money transfer services. Any person wishing to engage in banking must obtain a licence under the Banking Act.

If a person wishes only to conduct the lending of funds and not the acceptance of deposits, a registration of money lending business under the Money Lending Business Act would suffice. Lending of funds requires a banking licence only when it is conducted together with the acceptance of deposits.

If a person wishes to only provide money transfer services not exceeding JPY1 million per transfer, a registration of money transfer services under the Payment Services Act would suffice under the current regulatory framework. It should be noted, however, that the current regulatory framework for money transfer services is soon to be changed, as explained in **10. Horizon Scanning**.

Restrictions on Licensed Banks' Activities

The Banking Act provides for restrictions on the business scope of licensed banks. In particular, banks are not allowed to conduct any business other than banking, business incidental to banking, and certain business specifically permitted under the Banking Act or other laws. The Banking Act also provides for restrictions on the business scope of subsidiaries of licensed banks, although the restrictions applicable to banks' subsidiaries are not as strict as those applicable to banks themselves.

Requirements for a Banking Licence

Criteria for examination

The Banking Act requires the regulator to examine whether an applicant for a banking licence satisfies the following criteria:

- "the applicant has a sufficient financial basis to perform banking services soundly and efficiently, and has good prospects in relation to income and expenditure in connection with those services"; and
- "in light of such points as its personnel structure, the applicant has the knowledge and experience to perform banking services appropriately, fairly, and efficiently, and has sufficient social credibility" (Article 4, Paragraph 2 of the Banking Act).

In addition, the regulator is authorised to impose such conditions on a banking licence as it deems necessary in light of the above criteria.

Statutory requirements under the Banking Act

A bank must be a stock company incorporated under the Companies Act of Japan and must have (i) a board of directors, (ii) a board of company auditors, audit and supervisory committee or nominating committee, etc, and (iii) a financial auditor. The Banking Act stipulates fit and proper principles requiring certain directors and officers of a bank to have certain knowledge and experience and to have sufficient social credibility. The stated capital of a bank must be no less than JPY2 billion.

If an applicant for a banking licence is a foreign bank, it does not need to be a stock company incorporated under the Companies Act of Japan, but it is required to establish a branch in Japan. The fit and proper principles explained above will apply to the representative in Japan of such foreign bank. A foreign bank branch is required to keep assets corresponding to its stated capital within Japan in an amount of no less than JPY2 billion.

Application Process

The application process usually consists of the following steps with the FSA: (i) preliminary consultation, and (ii) formal application. In step (i), the applicant consults with the FSA and provides such information as is informally requested by the FSA for its preliminary examination. After completing this informal communication with the FSA, the applicant proceeds to step (ii) and submits application documents together with supporting materials to the FSA.

The Banking Act provides for a standard processing period for step (ii). In particular, the regulator must endeavour to process the application within one month from receiving such application. On the other hand, there is no standard processing period for step (i), as it is not a formal process under the Banking Act. The length of time required for step (i) is highly dependent on the circumstances surrounding individual applicants.

An applicant for a banking licence must pay JPY150,000 as a registration and licence tax for each application. This is the only statutory cost incurred in obtaining a banking licence. In practice, it is usual for an applicant to retain advisers to assist in the application process, and for the applicant to incur fees in relation to such advisers.

3. Control

3.1 Requirements for Acquiring or Increasing Control over a Bank

Notification of Large Volume Holding

A person who acquires more than 5% of the total voting rights in a bank must submit a notification to the regulator as required under the Banking Act. If the notified percentage of the voting rights increases or decreases by 1% or more, or if there is a change in the information stated in the notification, such person must submit a report on such change to the regulator.

Bank Major Shareholder

A person must obtain prior approval from the regulator to acquire 20% (or, as the case may be, 15%) or more of the total voting rights in a bank. Once approved, such person is called a "Bank Major Shareholder" under the Banking Act and will be subject to the supervision of the regulator. In particular, if the holding ratio of a Bank Major Shareholder exceeds 50%, the regulator has authority to order the Bank Major Shareholder to submit an improvement plan to ensure sound management of the bank when necessary.

Bank Holding Company

A Bank Holding Company is defined as a holding company that has a bank as its subsidiary. A subsidiary is defined as a company the majority of whose voting rights (ie, more than 50%) are held by another company. A person must obtain prior approval from the regulator to become a Bank Holding Company.

If a person wishes to acquire more than 50% of the total voting rights in a bank, there is an issue of whether such person must obtain approval as a Bank Holding Company or a Bank Major Shareholder. Approval as a Bank Holding Company will be required only if such person falls under the definition of a holding company. A holding company is defined as a company the majority of whose assets (ie, more than 50%) are comprised of shares in its subsidiaries in Japan.

A Bank Holding Company is subject to broader and stricter regulations than those applicable to a Bank Major Shareholder. The regulations applicable to a Bank Holding Company include:

- restrictions on the scope of business that a Bank Holding Company is permitted to conduct;
- restrictions on the scope of subsidiaries that a Bank Holding Company is permitted to own;
- governance requirements;
- capital adequacy requirements;
- accounting (including disclosure requirements); and
- supervision of the regulator (including authority to order a Bank Holding Company to submit an improvement plan to ensure sound management of the bank when necessary).

Foreign Shareholdings

There is no restriction on foreign shareholdings under the Banking Act. The above regulations on shareholdings in a bank (ie, notification of large volume holding, Bank Major Shareholder regulations, Bank Holding Company regulations) apply regardless of whether the shareholder is a domestic or foreign person. It should be noted, however, that the acquisition of a Japanese entity by a foreign investor may be subject to notification or other requirements under the Foreign Exchange and Foreign Trade Act.

4. Supervision

4.1 Corporate Governance Requirements

Under the Banking Act (Article 4-2), a bank must be a stock company (*kabushiki-kaisha*) as set forth in the Companies Act, with the following organs:

- a board of directors;
- a board of company auditors, a supervisory committee or a nominating committee, etc, as defined in Article 2, paragraph (12) of the Companies Act; and
- a financial auditor.

A foreign bank that has a branch office in Japan is not subject to this organisational requirement (Article 47, Paragraph 2 of the Banking Act).

In addition, VI-1 of the "Comprehensive Guidelines for Supervision of Major Banks, etc" issued by the FSA lists supervisory viewpoints to which the FSA would pay attention with respect to the corporate governance of a bank.

For example:

- as a general principle, corporate governance is important for the stability of the financial system, and for the sustainability and appropriate management of a bank;
- a listed bank or a listed bank holding company should comply with "Japan's Corporate Governance Code – Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term", issued by the Tokyo Stock Exchange, Inc;
- a listed bank or a listed bank holding company should appoint at least two independent outside directors who would contribute to sustainable corporate growth and the increase of corporate value; and
- a listed bank or a listed bank holding company should disclose its policy with respect to cross-shareholdings.

4.2 Registration and Oversight of Senior Management

Process of Election of Directors and Executive Officers

As a general rule not limited to a bank, a director of a stock company (*kabushiki-kaisha*) under the Companies Act is elected by a resolution at a shareholders' meeting (Article 329 of the Companies Act), while an executive officer of a company with a nominating committee, etc (as defined in Article 2, Paragraph (12) of the Companies Act) is elected by a resolution at a meeting of the board of directors. Neither the Companies Act nor the Banking Act stipulate a regulatory approval requirement in respect of the appointment of a director or an executive officer.

Restriction on the Concurrent Holding of Other Positions with Respect to Directors and Executive Officers

A director (or an executive officer, if the bank is a company with a nominating committee, etc, as defined in Article 2, Paragraph (12) of the Companies Act) that is engaged in the day-to-day business operations of a bank must not engage in the day-to-day business operations of any other company without the authorisation of the Prime Minister (Article 7, Paragraph 1 of the Banking Act).

When an application is filed for such authorisation, the Prime Minister must not grant that authorisation unless the Prime Minister finds that the particulars to which the application pertains are unlikely to interfere with the sound and appropriate management of bank services (Article 7, Paragraph 2 of the Banking Act).

A foreign bank that has a branch office in Japan is subject to these rules (Article 47, Paragraph 2 of the Banking Act).

Eligibility for Director or Executive Officer

A director engaged in the day-to-day business of a bank (or an executive officer engaged in the day-to-day business of a bank, if the bank is a company with nominating committee, etc, as defined in Article 2, Paragraph (12) of the Companies Act) must have the knowledge and experience to be able to carry out the business management of a bank appropriately, fairly and efficiently (Article 7-2, Paragraph 1 of the Banking Act).

In addition, no person subject to an order of commencement of bankruptcy proceedings who has not been discharged from bankruptcy and no person who is treated as the equivalent of the foregoing under foreign laws and regulations may become a director or an executive officer of a bank (Article 7-2, Paragraph 2 of the Banking Act).

A foreign bank that has a branch office in Japan is subject to these rules (Article 47, Paragraph 2 of the Banking Act).

Notification

A bank must file a prior notification with the Prime Minister when a director representing the bank or a director engaging in ordinary business of the bank is appointed or resigns (Article 53, Paragraph 1, Item 8 of the Banking Act and Article 35, Paragraph 1, Item 3 of the Regulation for Enforcement of the Banking Act).

A foreign bank that has a branch office in Japan is subject to these rules (Article 47, Paragraph 2 of the Banking Act).

Duties of Directors and Executive Officers

As a general rule under the Companies Act, directors and executive officers owe a duty of care and a duty of loyalty to the company (Article 330, Article 355 and Article 402, Paragraph 2 of the Companies Act, and Article 644 of the Civil Code).

A bank must not extend credit to its directors or executive officers under terms and conditions that are disadvantageous to the bank compared to the ordinary terms and conditions under which the bank extends credit (Article 14, Paragraph 1 of the Banking Act).

4.3 Remuneration Requirements

The Banking Act provides no rule with respect to remuneration paid by a bank to its directors, executive officers or employees.

1-2-3-5 of the "Comprehensive Guidelines for Supervision of Major Banks, etc" issued by the FSA lists supervisory viewpoints to which the FSA would pay attention with respect to remuneration paid by a bank to its directors, executive officers or employees, as follows:

- a bank's remuneration system is not appropriate if it drives excessive risk-taking by a director, an executive officer or an employee of the bank;
- the remuneration committee of a bank should supervise the bank's remuneration system so that such remuneration system is appropriately established and managed;
- the remuneration committee of a bank should check whether or not the amount of remuneration would have a material effect on the bank's core capital;
- the remuneration committee of a bank should communicate with the risk monitoring department of the bank;
- the remuneration committee of a bank should check whether or not its remuneration system causes excessive short-termism or becomes excessively performance-based; and
- the remuneration of staff in the risk monitoring department and compliance department should be determined independently from other business departments and based on the importance of their roles.

In cases where the FSA thinks that a bank's remuneration system is problematic as a result of regular off-site monitoring or inspection, it shall require the bank to submit a report under Article 24, Paragraph 1 of the Banking Act as necessary. If a serious problem is recognised, the FSA shall take administrative action, such as issuing an order for business improvement under Article 26 of the Banking Act.

5. AML/KYC

5.1 AML and CTF Requirements

Overview

The principal laws and regulations governing anti-money laundering and counter-terrorist financing are the Act on Prevention of Transfer of Criminal Proceeds (Act No. 22 of 2007) and the subordinate regulations enacted thereunder, including the Order for Enforcement of the Act on Prevention of Transfer of Criminal Proceeds (Cabinet Order No. 20 of 2008) and the Regulation for Enforcement of the Act on Prevention of Transfer of Criminal Proceeds (Ministry of Finance Order No. 1 of 2008).

In addition, the FSA issues "Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism", which clarify the required actions and expected actions to be implemented by financial institutions, such as banks, and how the FSA shall conduct monitoring going forward.

The Act on Prevention of Transfer of Criminal Proceeds provides for preventative measures in combating money laundering and terrorist financing, by imposing obligations such as customer due diligence, record keeping and the reporting of suspicious transactions on "specified business operators". A bank is one such "specified business operator".

Customer Due Diligence (Article 4 of the Act on Prevention of Transfer of Criminal Proceeds)
When a bank enters into a transaction ("Specified Transaction") listed in Article 7 of the Order for Enforcement of the Act on Prevention of Transfer of Criminal Proceeds (Cabinet Order No. 20 of 2008) with its customers who are natural persons, it is required to verify their identification data (name, address and date of birth), the purpose and intended nature of the transaction, and the customer's occupation, by checking their identification documents, such as a driver's licence.

When a bank enters into a Specified Transaction with its customers who are legal persons, such as corporations, it must verify their identification data (the name and location of the head office or main office), the purpose and intended nature of the transaction, the type of business, and the beneficial owner(s).

When a bank enters into a Specified Transaction with an agent or a representative of a customer, it must verify the identification data in respect of such agent or representative.

When a bank enters into a transaction that has a high risk of being related to money laundering or terrorist financing, such as a transaction where the bank suspects its counterparty is disguising its identity, the bank is required to verify items related to verification at the time of the transaction, using a more robust method.

Record-Keeping
A bank is required to prepare and preserve verification records collected at the time of the transaction, as well as measures taken for verification of the customer at the time of the transaction, for seven years from the day when the transaction is made or when an agreement related to the transaction is terminated, depending on the type of the transaction (Article 6 of the Act on Prevention of Transfer of Criminal Proceeds).

In addition, a bank is required to prepare records of the date and contents of transactions, and to keep these records for seven years from the date of such transaction (Article 7 of the Act on Prevention of Transfer of Criminal Proceeds).

Reporting Suspicious Transactions (Article 8 of the Act on Prevention of Transfer of Criminal Proceeds)
A bank is required to file a suspicious transaction report with the competent administrative authority in cases where assets received through a transaction are suspected to be criminal proceeds, or where the customer is suspected to be engaged in money laundering.

6. Depositor Protection

6.1 Depositor Protection Regime

Scheme Administration and Supervision
The Deposit Insurance Corporation (DIC) is a special corporation organised under the Deposit Insurance Act of Japan (Act No. 34 of 1971 – DIA) and administers the deposit insurance system. The Prime Minister generally supervises DIC's operation of the system, and also determines or approves specific administrative procedures in respect of failed financial institutions or successors thereto. The Prime Minister delegates most of his/her authorities under DIA to the FSA.

Scope of Protection
The deposit insurance system protects depositors by either providing financial assistance to a successor financial institution and thereby indirectly making insurance proceeds available to depositors ("Financial Assistance Method"), or directly paying insurance proceeds to depositors of a failed financial institution ("Insurance Pay-out Method"). The Financial Assistance Method is more cost-effective and causes less confusion compared to the Insurance Pay-out Method. DIC has resorted to the Financial Assistance Method in dealing with almost all failed financial institutions.

Either way, only those with insured deposits with insured financial institutions are protected under the system up to the statutory limit (if applicable).

Insured financial institutions
Banks and other deposit-taking financial institutions licensed in Japan are insured under the deposit insurance system, with some exceptions.

One of the exceptions is foreign branches of licensed financial institutions. Another exception is Japanese branches of foreign banks: under the Banking Act, instead of establishing a licensed bank in Japan, foreign banks may obtain a licence and conduct banking business through their branches in Japan; however, such licensed branches are not covered by the deposit insurance system. Agricultural/fishery co-operatives and related financial institutions are insured not under the deposit insurance system but under a separate "savings" insurance system.

Governmental financial institutions are not covered by these insurance systems. Insurance and securities firms receive premiums, margins and other types of funds from their customers, the economic nature of which funds is similar to deposits; however, these firms are not deposit-taking financial institutions and are thus not insured under the aforementioned insurance systems. Nonetheless, part of such customer funds are covered by separate customer protection systems. As described in **9.1 Legal and Regulatory Framework**, these firms are also subject to the new resolution regime established in line with the FSB Key Attributes.

Insured deposits

Deposits for payment and settlement ("Settlement Deposits") with the insured financial institutions are fully covered by the deposit insurance system (ie, without being restricted by the statutory limit applicable to General Deposits – defined below). To qualify as Settlement Deposits, the deposits must bear no interest, be redeemable on demand, and be used for payment and settlement.

Deposits other than Settlement Deposits ("General Deposits") are also protected but only within the statutory limit of JPY10 million in principal plus interest thereon, per depositor, per insured financial institution.

Certain deposits are disqualified as Settlement Deposits and General Deposits. Among others, foreign currency deposits are disqualified, given the volatility of exchange rates. Negotiable certificates of deposit, bearer deposits and deposits under an alias or fictitious name are also disqualified due to difficulties in identifying the true depositors. Other examples of disqualified deposits are deposits from insured financial institutions and deposits in respect of Japan offshore market accounts.

In addition to Settlement Deposits and General Deposits, when an insured financial institution is processing a fund remittance or certain other settlement transactions requested by a customer, obligations in relation to the customer are also fully protected. If the settlement transactions are denominated in a foreign currency or requested by other insured financial institutions, the obligations thereunder are disqualified and not insured.

Uninsured deposits or obligations may be paid as tenders or dividends through bankruptcy/rehabilitation proceedings, depending on the status of assets of the relevant failed financial institution (see **9.1 Legal and Regulatory Framework**).

Funding of Deposit Insurance System

DIC is funded mainly by the receipt of insurance premiums from insured financial institutions and capital contributions from the government, BOJ and certain financial institutions. DIC also raises funds by issuing bonds or by borrowing from financial institutions.

7. Bank Secrecy

7.1 Bank Secrecy Requirements

Duty of Confidentiality

Neither the Banking Act nor any other act contains any provision in respect of bank secrecy requirements. In Japan, banks' duty of confidentiality has been established and developed by the case law of the Supreme Court, which has held that a financial institution owes its customers a duty of confidentiality, which is based on business practices or an agreement between the financial institution and its customer; the financial institution may not disclose information on transactions between itself and its customer, information on a customer's credit risk, or any other customer information to another person, unless for good reason.

Based on such established case law, Article 12-2, Paragraph 2 of the Banking Act provides that a bank must appropriately handle customer information it acquires in the course of its services. In addition, III-3-3-3 of the "Comprehensive Guidelines for Supervision of Major Banks, etc" issued by the FSA states that the FSA would pay attention to whether or not a bank has established an appropriate information management system.

It is generally understood that a bank may disclose customer information upon reasonable grounds, such as when the customer explicitly or implicitly consents to such disclosure, or when the bank is legally required to disclose customer information. It should be noted that a bank is not always allowed to transfer its customer information to its affiliates under such duty of confidentiality. Because the bank's duty of confidentiality has been established and developed by the case law, it is sometimes unclear whether or not a bank may disclose certain customer information without breaching its duty of confidentiality, including the case where a bank shares certain customer information with its affiliates.

When a bank breaches such duty of confidentiality, it would be liable for damage to the customer arising from such breach. In addition, if, as a result of regular offsite monitoring or inspection, the FSA thinks that a bank's information management system is problematic, it shall require the bank to submit a report under Article 24, Paragraph 1 of the Banking Act as necessary. If a serious problem is recognised, the FSA shall take administrative action, such as issuing an order for business improvement under Article 26 of the Banking Act.

Personal Data Protection

If a bank's customer is a natural person, the customer information would fall under "personal data" under the Act on the Protection of Personal Information (Act No 57 of 2003), and the disclosure of such customer information would be subject to personal data protection regulations, including the Act on the Protection of Personal Information. A bank is required to prevent the leakage, loss or damage of customer information that falls under personal data, and to conform to the requirements regarding the scope and purpose of any shared use.

Firewall Regulations

A bank is subject to so-called firewall regulations, the original aim of which is to prevent the bank from abusing its dominant bargaining position. These firewall regulations prohibit a bank from sharing its non-public customer information with its affiliates without the customer's prior approval, provided, however, that (i) sharing of non-public customer information for internal management purposes is permitted and (ii) sharing of non-public corporate customer information is permitted if the relevant bank provides the corporate customer with an opt-out opportunity in advance.

8. Prudential Regime

8.1 Capital, Liquidity and Related Risk Control Requirements

Adherence to Basel III Standards for Internationally Active Banks

Under the Banking Act, banks must meet capital, liquidity and related risk control requirements. Banks are also required to avoid having large exposures to single counterparties. To enable group-level risk management, the Banking Act and regulations thereunder cover not only banks but also bank holding companies.

This risk control framework aims to be consistent with the Basel III standards set by the Basel Committee on Banking Supervision (BCBS), to the extent applied to internationally active banks (ie, banks having a branch or a banking subsidiary overseas).

Reviews of this risk control framework under the BCBS's Regulatory Consistency Assessment Programme (RCAP) have assessed the framework as being "compliant" with the requirements of the Basel III standards that relate to risk-based capital, liquidity (LCR) and G-SIBs and D-SIBs.

No results of assessments of other requirements, such as the stable funding ratio (NSFR) and large exposure framework, are currently available; however, the FSA has continuously amended the relevant regulations with a view to adhering to the updated Basel III standards in these areas.

The FSA has announced that the national implementation of the finalised Basel III standards has been postponed until the fiscal year ending March 2023, in light of the related announcement of the Group of Central Bank Governors and Heads of Supervision (GHOS), the oversight body of the BCBS.

Risk Control Framework for Domestic Banks

Domestic banks are also subject to the aforementioned risk control framework, but under less strict requirements compared to internationally active banks. For instance, domestic banks are only required to meet a minimum capital ratio (the ratio of "core" capital amount to risk asset amount) of 4%; on the other hand, several types of threshold are set as the minimum capital ratio of internationally active banks (eg, 8% for "Tier 1" plus "Tier 2" equity, 6% for "Tier 1" equity and 4.5% for "Common Equity Tier 1"). Domestic banks are not subject to capital buffer requirements and certain other risk management rules.

Risk Management and Correction Measures

Under the aforementioned risk control framework, banks are primarily responsible for managing their risks. The FSA continually monitors the risk status of banks, and takes early correction measures if a bank fails to meet the minimum capital requirement, which include the order to file an improvement plan, the order to enhance capital and the order to suspend or abolish the whole or part of a business. As a preventative measure, the FSA may also issue an early warning to a bank that satisfies the minimum capital requirement but in relation to which bank there is still a risk-related concern requiring improvement. With respect to internationally active banks, a failure to meet capital buffer requirements leads to an order from the FSA to restrict capital distribution.

9. Insolvency, Recovery and Resolution

9.1 Legal and Regulatory Framework

Administrative Procedures

Ordinary resolution procedures

The FSA appoints DIC as a "financial administrator" of a financial institution that has excessive liabilities or is at risk of suspending repayment of deposits, if its operations are extremely inappropriate or if its dissolution seriously hinders smooth fund flows and the convenience of its customers in relevant regions or sectors.

Once appointed as financial administrator, DIC is authorised to control the operations and manage the assets of the failed financial institution. With such authority, DIC is expected to promptly transfer such institution's business, including deposits, to a successor financial institution so that DIC may be able to provide financial assistance to such successor financial institution for the protection of depositors under the Financial Assistance Method. The amount of such assistance is limited to the amount of the insurance proceeds. If DIC fails to identify a successor financial institution promptly, the FSA directs DIC to establish a bridge bank to which the business of the failed financial institution is transferred for the time being. DIC attempts to re-transfer the business from the bridge bank once a successor financial institution is identified.

Only financial institutions insured under the deposit insurance system (see **6.1 Depositor Protection Regime**) are subject to these resolution procedures.

Resolution procedures in the face of systemic risk

In the face of an extremely serious threat to the maintenance of the credit stability of Japan or relevant regions (systemic risk), the Prime Minister convenes the Financial System Management Council and determines the necessity of financial assistance in relation to a failed or insolvent financial institution (the so-called "Item 2 Measure"). Unlike the Financial Assistance Method under the ordinary resolution procedures, this Item 2 Measure enables financial assistance exceeding insurance proceeds, given the necessity to address the emerging systemic risk. Following the determination by the Prime Minister, the FSA appoints DIC as financial administrator, and DIC provides financial assistance exceeding the insurance proceeds.

If the financial institution is insolvent and has failed, and if the systemic risk is too serious to be avoided by the Item 2 Measure, the Prime Minister determines the necessity of the acquisition of shares in such financial institution (so-called special crisis management or Item 3 Measure). Following the determination by the Prime Minister, the FSA directs DIC to acquire shares in the failed and insolvent financial institution, and thereby substantially nationalises such institution.

Financial institutions that are not eligible for these measures (ie, those which are neither insolvent nor have failed) may still receive a capital injection from DIC to recover their capital adequacy ratio in line with the direction of the FSA (so-called Item 1 Measure).

Only financial institutions insured under the deposit insurance system (see **6.1 Depositor Protection Regime**) are subject to these resolution procedures.

A new regime in line with FSB Key Attributes

The FSB Key Attributes were implemented by amending DIA in 2013 and thereby granting the Prime Minister and DIC authority to resolve financial institutions.

Under the amended DIA, the Prime Minister may determine that, following the convening of the Financial System Management Council, it is necessary to take recovery or resolution measures for financial institutions where, without such measures, there is a risk of extreme disruption to the Japanese financial market or other financial systems.

It is noteworthy that not only insured financial institutions (ie, insured banks and other deposit-taking financial institutions; see **6.1 Depositor Protection Regime**) but also Japanese branches of foreign banks, licensed insurance and securities firms and holding companies thereof may be subject to this new regime. DIC plays an important role under this regime, including through the provision of financial assistance to successors of insolvent financial institutions with a view to ensuring the performance of important transactions in the financial market. DIC also provides liquidity even to solvent financial institutions as necessary.

This new regime is generally in line with the FSB Key Attributes, including the recovery planning, the temporary stay, contractual bail-in mechanism and ex post recovery of costs from the industry.

Judicial Procedures

The commencement of the aforementioned administrative procedures does not exclude the possibility of judicial procedures against a failed financial institution in relation to its bankruptcy/rehabilitation. Rather, to achieve the aim of each of these administrative procedures, it is essential to concurrently commence bankruptcy/rehabilitation proceedings and thereby prevent the deterioration of such failed institution's assets and enable it to perform its obligations (eg, with respect to uninsured deposits; see **6.1 Depositor Protection Regime**) to the extent permitted under such proceedings. Although DIA sets out certain provisions addressing the conflict between the administrative and judicial procedures, there are no insolvency preference rules applicable to deposits.

10. Horizon Scanning

10.1 Regulatory Developments

Amendment to ASFI and PSA

On 5 June 2020, the Diet passed a bill to amend the Act on Sales, etc. of Financial Instruments (ASFI) and the Payment Services Act (PSA) for the purposes of introducing a new regulatory framework for the brokerage of financial products, and revising the current regulatory framework for payment and settlement. This amendment ("Amendment") was promulgated on 12 June 2020 and will enter into force within 18 months of the date of promulgation.

New framework for brokerage of financial products

Outline

The Amendment will introduce a new regulatory framework entitled "Financial Service Brokerage" in order to facilitate a one-stop service by brokers to offer financial products throughout all sectors of banking, insurance and securities. In particular, this is expected to encourage online service providers or platforms to add financial products to the services they offer to users. From the viewpoint of the banking sector, this would be regarded as the creation of a new sales channel. Banks would need to consider whether and how to collaborate with this new sales channel.

The new regulatory framework will have two unique characteristics:

- cross-sectoral licensing across all sectors of banking, insurance and securities; and
- non-adoption of the existing "affiliation framework".

Cross-sectoral licensing

Under the current legislation, brokers wishing to provide a one-stop service must obtain the necessary licence under each relevant statute for each sector (eg, the Banking Act; the Insurance Business Act; the Financial Instruments and Exchange Act).

The Amendment will revise the ASFI (and rename it the "Act on Provision of Financial Services") to introduce the new regulatory framework of "Financial Service Brokerage", which will allow brokers to offer financial products in any or all sectors across banking, insurance and securities with only one licence (registration) as a "Financial Service Broker". Having said that, the current regulatory framework for brokerage under each sectoral statute will also continue in parallel with the new regulatory framework to be introduced under the amended ASFI.

Under the amended ASFI, Financial Service Brokerage comprises four categories:

- Deposit Intermediary;
- Insurance Intermediary;
- Securities Intermediary; and
- Lending Business Loan Intermediary.

Registration as a Financial Service Broker will be required for each of these categories. In particular, applicants for registration as a Financial Service Broker will need to disclose in their application documents which of the four categories they wish to operate within. The regulator will then proceed to examine the applicants according to the categories indicated. Brokers that wish to change the categories under which they are registered will need to apply to the regulator again to become registered under the desired new categories.

Non-adoption of the affiliation framework

The current regulatory framework for brokers under each relevant statute generally adopts an "affiliation framework", under which brokers are affiliated with (or belong to) specific financial institutions (eg, banks, insurance companies, securities firms). In turn, the affiliated financial institutions are responsible for the supervision of the affiliated brokers and are liable for any damage caused to customers by the affiliated brokers.

The amended ASFI does not apply the same affiliation framework to Financial Service Brokers. Consequently, Financial Service Brokers will be able to offer the products of multiple financial institutions more easily than existing brokers, who would need to be affiliated with specific financial institutions under the affiliation framework.

On the other hand, as there will be no supervision over the conduct of Financial Service Brokers by affiliated financial institutions, the amended ASFI will impose the following restrictions on Financial Service Brokers in order to protect customers:

- Financial Service Brokers will not be permitted to act as an agent and will only be permitted to act as an intermediary;
- Financial Service Brokers will not be permitted to offer certain financial products that require a highly technical explanation; and
- Financial Service Brokers will not be permitted to receive deposits of money or other property from customers.

Furthermore, no affiliated financial institutions will owe any liability for damage caused by Financial Service Brokers to customers. In other words, customers will not be able to claim damage against affiliated financial institutions and will only be able to make claims against the Financial Service Brokers themselves. Therefore, the amended ASFI will generally require Financial Service Brokers to set aside a security deposit of a certain amount for the purpose of ensuring the financial ability of Financial Service Brokers to pay compensation for damage to customers if necessary.

Revision to framework for payment and settlement

Under Japanese law, money transfer services are regulated by either the Banking Act or the PSA.

Historically, only banks licensed under the Banking Act were allowed to provide money transfer services. In 2009, the PSA was enacted to allow registered service providers to provide money transfer services, subject to an upper limit of JPY1 million per transfer.

The Amendment will make several revisions to the current regulatory framework for payment and settlement under the PSA, with the most notable change being an amendment to the aforementioned upper limit imposed on money transfer service providers registered under the PSA. This would have an impact on the banking sector as it is expected to promote competition between money transfer service providers registered under the PSA and banks licensed under the Banking Act.

New type of services for a large amount transfer

The Amendment will introduce a new type of money transfer service, under which it will be permitted to transfer amounts exceeding JPY1 million but which will be subject to stricter regulations (Type I Money Transfer Services).

To conduct Type I Money Transfer Services, a banking licence under the Banking Act will not be necessary, but approval will be required in addition to registration under the PSA. The PSA will also impose the following stringent restrictions regarding the retention of money on the approved providers of Type I Money Transfer Services:

- a prohibition on taking receipts of money from customers if the transaction details (eg, the amount, date and time of remittance) are unconfirmed; and
- a prohibition on taking receipts of money from customers for a period longer than necessary for the remittance.

New type of services for a small amount transfer

The Amendment will also introduce a type of money transfer service under which it will only be permitted to transfer amounts below a certain limit – yet to be determined by a separate Cabinet Order – and which will be subject to less strict regulations (Type III Money Transfer Services).

Money transfer service providers are generally required under the PSA to protect in-transit money by way of statutory deposit, bank guarantee or trust agreement. However, the Amendment will allow providers of Type III Money Transfer Services to protect in-transit money by way of simple deposit in a segregated bank account, as an alternative to statutory deposit, bank guarantee or trust agreement. In relation to this method of simple bank deposit, external auditing of such bank account will be required.

Amendment to existing type of services

Lastly, the existing money transfer services regulated under the current PSA will be categorised as Type II Money Transfer Services under the amended PSA. Regulations applicable to Type II Money Transfer Services will basically remain unchanged except for certain revisions, including the introduction of a general requirement to take measures to prevent the retention of money that is not related to a remittance (which could be viewed as the acceptance of deposits without a banking licence).

Special Provisions of the Antimonopoly Act

On 20 May 2020, the Diet passed a bill to create special provisions of the Antimonopoly Act to facilitate mergers among regional banks to ensure the sustainability of essential services for local residents rendered by the regional banks in municipalities. The new law will enter into force on 27 November 2020.

By way of background, services rendered by regional banks in the respective municipalities are perceived as "essential services" that are the basis for the lives and economic activities of local residents, being difficult to be replaced by other operators/providers. However, the existing regional banks are facing difficulties in providing such essential services in a sustainable manner, for reasons such as declining population.

To ensure the sustainability of such essential services, the new law will exempt from the relevant provisions of the Antimonopoly Act certain cases of business enhancement through mergers among regional banks in municipalities that may conflict with the Antimonopoly Act. This would have an impact on the banking sector as it is expected to motivate regional banks to consider merging as one of their strategies for future survival.

Discussion on Amendments to Banking Act

On 30 September 2020, the FSA announced that it had started discussions on new amendments to the Banking Act among the members of the "Working Group on the Japanese Banking System" of the Financial System Council.

Amendments to be discussed will include:

- relaxation of the restrictions on the scope of business by banks;
- relaxation of the restrictions on the scope of business by banks' subsidiaries;
- amendment to the regulations on Bank Major Shareholders and Bank Holding Companies; and
- relaxation of firewall requirements between banks and securities firms, such as the restrictions on the sharing of customer data.

Nagashima Ohno & Tsunematsu is the first integrated full-service law firm in Japan and one of the foremost providers of international and commercial legal services based in Tokyo. The firm's overseas network includes offices in New York, Singapore, Bangkok, Ho Chi Minh City, Hanoi and Shanghai, associated local law firms in Jakarta and Beijing where the lawyers are on-site, and collaborative relationships with prominent local law firms throughout Asia and other regions. In representing leading domestic and international clients, the firm has successfully structured and negotiated many of the largest and most significant corporate, finance and real estate transactions related to Japan. It has extensive corporate and litigation capabilities spanning key commercial areas such as antitrust, intellectual property, labour and taxation, and is known for ground-breaking domestic and cross-border risk management/corporate governance cases and large-scale corporate reorganisations. The approximately 500 lawyers of the firm, including more than 30 experienced foreign attorneys from various jurisdictions, work together in customised teams to provide clients with the expertise and experience specifically required for each matter.

Authors

Atsushi Sakai is a partner at Nagashima Ohno & Tsunematsu. His key practice areas are financial regulations, financial compliance, insurance and general corporate. From 2005 to 2007, he worked at the Financial Services Agency of Japan (FSA) on the project to enact the Financial Instruments and Exchange Act of Japan (FIEA). He has authored a number of books and articles on financial regulations, including commentaries on the FIEA co-authored by the project team at the FSA.

Ohki Mizuno is a partner at Nagashima Ohno & Tsunematsu. His key practice areas are banking, financial regulations, securitisation/structured finance/trust and crypto-assets. From 2016 to 2019, he was an associate professor at the University of Tokyo Graduate Schools for Law and Politics. He has been adjunct lecturer of the University of Tokyo since 2019. His most recent publications are "Advanced Financial Instruments and Exchange Act, 3rd Edition" (co-author) (August 2019) and the newsletter "Preparation for a LIBOR alternative" (July 2019).

Hideaki Suda is a partner at Nagashima Ohno & Tsunematsu. His key practice areas are securitisation, structured finance, trust, financial regulations, financial compliance, asset management funds, banking, general corporate, data protection and privacy. He is a member of the Financial Instruments and Exchange Act research division of the legal research institute of the Dai-ichi Tokyo Bar Association, and has published a number of professional articles on trust and regulation-related issues.

Nagashima Ohno & Tsunematsu

JP Tower
2-7-2 Marunouchi
Chiyoda-ku
Tokyo 100-7036
Japan

Tel: +81 3 6889 7000
Fax: +81 3 6889 8000
Email: info@noandt.com
Web: www.noandt.com/en/index.html

NAGASHIMA OHNO & TSUNEMATSU