The Legal 500 & The In-House Lawyer
Comparative Legal Guide
Japan: Banking & Finance (2nd edition)

This country-specific Q&A provides an overview to banking and finance laws and regulations that may occur in Japan.

This Q&A is part of the global guide to Banking & Finance. For a full list of jurisdictional Q&As visit http://www.inhouselawyer.co.uk/practice-areas/banking-finance-2nd-edition/

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1. **What are the national authorities for banking regulation, supervision and resolution in your jurisdiction?**

   The Financial Services Agency (FSA) has the authority under the Banking Act to regulate and supervise banks in Japan.

   The resolution of failed banks is performed by the Deposit Insurance Corporation of Japan (DICJ), although the resolution commencement and methods are ordered by the FSA or the Prime Minister and deliberations by the Financial Crisis Response Council, consisting of the Prime Minister, the Minister of Finance, the Commissioner of the FSA

and the Governor of the Bank of Japan, may be required, pursuant to the Deposit Insurance Act.

2. Which type of activities trigger the requirement of a banking license?

Activities that trigger the requirement of a banking license are (i) deposit-taking and lending and (ii) fund transfers. Deposit-taking, by itself, is a quasi-banking business, which also requires a banking license.

Lending, by itself, does not require a banking license, but requires a money lending business registration pursuant to the Money Lending Business Act. However, since a banking license covers money lending, a licensed bank does not need a separate money lending business registration.

3. Does your regulatory regime know different licenses for different banking services?

As mentioned in No. 2 above, lending, by itself, does not require a banking license. Thus, non-banks with a money lending business registration pursuant to the Money Lending Business Act can lend money, as long as the money is not funded by deposits.

In addition, the Payment Services Act was enacted in 2009. This law allows registered fund transfer service providers to engage in fund transfers of up to 1 million yen per transaction under a looser regulatory requirement, as compared to a banking license.

4. Does a banking license automatically permit certain other activities, e.g., broker dealer activities, payment services,

issuance of e-money?

A banking license automatically permits payment services.

A bank is allowed to conduct certain other businesses incidental to the banking business, such as issuing guarantees, securities lending, being a custodian, and making finance leases, under the Banking Act. However, if an incidental business requires a separate license or other qualifications, the bank must satisfy those other requirements as well.

For example, a banking license does not automatically permit broker dealer activities. The Financial Instruments and Exchange Act (FIEA) maintains a separation between banking and securities businesses. If a bank is registered with the FSA pursuant to the FIEA, it is allowed to conduct certain securities businesses, such as dealing with government bonds, investment trusts and certain derivatives transactions, but not certain other securities businesses, such as dealing with corporate bonds and equities.

As for the issuance of e-money, it is divided into two services. One is a prepaid service, which is used only for the payment of goods and services; and the other is a fund transfer service, which may be used not only for the payment of goods and services but also for simply remitting money without any underlying transaction. Banks are required to register with the FSA pursuant to the Payment Services Act before they can provide prepaid services, but not for fund transfer services which are considered banking business (see Nos. 2 and 3).

5. Is there a “sandbox” or “license light” for specific activities?

As mentioned in No. 3 above, registered fund transfer service providers are allowed to engage in fund transfers of up to 1 million yen per transaction under a looser regulatory requirement as compared to a banking license.

While there is no regulatory "sandbox" for specific activities or financial services, the Act on Special Measures for Productivity Improvement, which took effect in June 2018,

introduced a regulatory sandbox on a project basis. The relevant ministry (including the FSA, where financial regulations are relevant) will certify “testing projects”, which will be exempted from complying with certain regulations for a certain testing period. This scheme may be used by banks.

6. Are there specific restrictions with respect to the issuance or custody of crypto currencies, such as a regulatory or voluntary moratorium?

With respect to the custody of crypto currencies, pursuant to the amendment to the Payment Service Act, which took effect in April 2017, registration as a virtual currency exchange service provider is required if custody services are provided in connection with an exchange service. Registered virtual currency exchange service providers are required to perform KYC checks and report suspicious transactions to the FSA, among others.

As of January 2019, there is no requirement to register as a virtual currency exchange service provider to provide custody services if an exchange service will not be provided. However, there is a proposal to impose a registration requirement for crypto currency custody service providers, similar to virtual currency exchange service providers.

There is also a proposal by the Study Group on Virtual Currency Exchanges in the FSA, which is likely to lead to legislation, to strengthen the regulations on virtual currency exchange service providers, including imposing registration requirements on service providers dealing in virtual currency margin trading with conduct regulations and a leverage ratio limitation.

With respect to the issuance of crypto currencies, while it is currently not explicitly regulated, there is a proposal to explicitly regulate investment-like initial coin offerings (ICO), similar to securities under the FIEA. If such proposal is enacted, in addition to registration with the FSA and filing disclosure documents, the offer of newly issued crypto currencies to non-qualified investors will also be restricted.

7. What is the general application process for bank licenses and what is the average timing?

The application process for bank licenses may be divided into two stages: consultation and formal examination. A preliminary examination process before formally submitting a license application is also available and is usually used when establishing a new bank. The standard consultation period is not officially published and may vary widely depending on the circumstances, but the average timing seems to be around one year. The Enforcement Ordinance of the Banking Act requires the FSA to make efforts to process the formal examination within a standard period of one month.

8. Is mere cross-border activity permissible? If yes, what are the requirements?

The Banking Act does not prohibit Japanese banks from engaging in cross-border activities in accordance with applicable foreign law. However, it prohibits foreign banks from engaging in banking business in Japan without establishing a branch and obtaining a license from the FSA. A foreign bank can engage in cross-border activities from outside Japan if it establishes a branch or subsidiary in Japan to perform agency activities for the foreign bank under an authorisation for those foreign bank agency activities from the FSA.

9. What legal entities can operate as banks? What legal forms are generally used to operate as banks?

To obtain a banking license in Japan, the applicant must be a kabushiki kaisha (a stock company) with a minimum stated capital of 2 billion yen. The kabushiki kaisha is a common form of business entity in Japan. Some foreign financial institutions have used kabushiki kaisha as the corporate entity for their banking subsidiaries in Japan.

However, most foreign banks establish a branch in Japan. The branch must hold assets of 2 billion yen or more in Japan in the form of Japanese government bonds, deposits with the Bank of Japan or other Japanese banks, or other assets designated by the Enforcement Ordinance of the Banking Act.

10. What are the organizational requirements for banks, including with respect to corporate governance?

With respect to corporate governance, a bank must have:

(i) a board of directors;
(ii) a board of statutory auditors (kansa-yaku); and
(iii) an accounting auditor.
In lieu of a board of statutory auditors, the bank may elect to have alternative corporate governance structures and establish:
(i) an audit and supervisory committee (kansa-tou iinkai); or
(ii) a nominating committee (shimei iinkai), an audit committee (kansa iinkai) and a compensation committee (houshuu iinkai).

The bank must also have risk control, compliance and internal audit oversight structures as required by the FSA's Supervisory Guidelines.

11. Do any restrictions on remuneration policies apply?

The FSA's Supervisory Guidelines require a bank to establish an independent committee to set its remuneration policy, assess whether the policy harms its financial soundness and capital adequacy, coordinate with the bank's risk control divisions and monitor the remuneration. The guidelines also require the bank to determine the remuneration of its risk control and compliance divisions independently from other divisions, ensure that any performance-based bonus does not harm its financial soundness, and remedy any remuneration structure that is harmful to risk control.

Additionally, the bank must make available to the public certain matters relating to its remuneration policy.

12. **Has your jurisdiction implemented the Basel III framework with respect to regulatory capital? Are there any major deviations, e.g., with respect to certain categories of banks?**

The FSA has implemented the Basel III framework with respect to regulatory capital for banks with international operations, and applies a more simplified capital adequacy regulation to banks without international operations.

13. **Are there any requirements with respect to the leverage ratio?**

A bank with international operations is required to disclose its leverage ratio on a quarterly basis. The FSA released the draft leverage ratio rule to the public for comment in December 2018 and plans to introduce the minimum leverage ratio of 3% in March 2019.

14. **What liquidity requirements apply? Has your jurisdiction implemented the Basel III liquidity requirements, including regarding LCR and NSFR?**

The FSA is implementing the Basel III LCR. A bank with international operations must maintain the minimum LCR, which is currently 100%.

The FSA released the draft NSFR rule to the public for comment in June 2018 and plans to introduce the minimum NSFR of 100% in March 2019.

15. Do banks have to publish their financial statements? Is there interim reporting and, if so, in which intervals?

Banks are required to publish their financial statements on a semi-annual basis under the Banking Act. Separately from the financial statements, capital adequacy and related information are required to be disclosed on a quarterly basis, pursuant to the FSA rules, in line with the third pillar of Basel III. Note that banks listed on a stock exchange are also required to publish their financial statements on a quarterly basis.

16. Does consolidated supervision of a bank exist in your jurisdiction? If so, what are the consequences?

A holding company that holds more than 50% of the voting rights of a bank must obtain an authorisation to be a bank holding company, which is regulated by the Banking Act on a consolidated basis (e.g., maintenance of capital adequacy on a consolidated basis, and refraining from engaging in businesses other than banking and other financial businesses through its subsidiaries). Similar consolidated supervision also applies to banks that have subsidiaries.

17. What reporting and/or approval requirements apply to the acquisition of shareholdings in, or control of, banks?

A reporting requirement applies to the holding of more than 5% of the voting rights in a bank. The report must be submitted to the FSA within five days of acquiring those voting rights.

Furthermore, authorisation by the FSA is required to hold at least 20% (or 15%) of the voting rights in a bank. The 15% threshold only applies where the holder may have the capability to influence the bank (e.g., delegation of a representative director or other director, or any equivalent position; provision of significant financing or technology; or having significant sales and purchases or any other operational or business transactions).

18. Does your regulatory regime impose conditions for eligible owners of banks (e.g., with respect to major participations)?

Authorisation by the FSA is required to hold the voting rights of a bank that are at or above the threshold of 20% or 15%, as applicable (see No. 17). The applicant for such an authorisation is examined on whether (i) the sound and appropriate management of the services of the bank is unlikely to be impaired in light of particulars of the funds for the acquisition of the voting rights, the purpose of holding the voting rights, or any other particulars, (ii) the sound and appropriate management of the services of the bank is unlikely to be impaired in light of the financial condition, income and expenditures of the applicant and its subsidiaries, and (iii) the applicant has a sufficient understanding of the public nature of bank services and has sufficient social credibility.

19. Are there specific restrictions on foreign shareholdings in banks?

There are no specific restrictions on foreign shareholdings in banks. Foreign shareholders are subject to the same requirements as those for domestic shareholders.

20. Is there a special regime for domestic and/or globally systemically important banks?

The FSA designated three banking groups as globally systemically important banks (G-SIBs) and two banking groups as domestic systemically important banks (D-SIBs) in 2015. Both categories are subject to capital surcharge and are required to maintain higher Common Equity Tier 1 ratios.

G-SIBs and D-SIBs are also required to have recovery and resolution plans, and to comply with the Principles for Effective Risk Data Aggregation and Risk Reporting issued by the Financial Stability Board (FSB).

Under the FSA's Supervisory Guidelines, G-SIBs are required to establish a nominating committee, an audit committee and a compensation committee (see No. 10), or have each of their major banking subsidiaries appoint an independent director.

21. What are the sanctions the regulator(s) can order in the case of a violation of banking regulations?

The FSA may order a bank to take remedial measures, suspend all or part of its business, deposit its assets, or take other necessary measures for the bank's sound and appropriate operation.

If a bank violates the Banking Act or other laws, its articles of incorporation, or the FSA's orders, or commits an act that harms the public interest, the FSA may order the bank to suspend all or part of its business or dismiss its directors, or revoke its banking license.
Other than these administrative sanctions, the regulators cannot sue banks before a civil court in Japan to seek civil penalties.

22. What is the resolution regime for banks?

If a bank's liabilities exceed its assets, or a bank has suspended, or is likely to suspend, the repayment of deposits, the Prime Minister may appoint DICJ as a Financial Reorganization Administrator and order the bank to be under the control of DICJ pursuant to the Deposit Insurance Act. The Financial Reorganization Administrator will take control of the assets of the bank, dispose of the assets and search for another institution that is willing to take over the bank's business.

In addition, to cope with the risk of harming national or regional financial systems, the Prime Minister may authorise DICJ to:

(i) subscribe for shares or subordinated bonds to enhance the bank's regulatory capital;

(ii) provide financial aid in excess of the expected pay-off cost (in case the bank has suspended, or is likely to suspend, the repayment of deposits, or its liabilities exceed its assets) (“2-go sochi”); or
(iii) acquire all of the bank’s shares (in case the bank has suspended, or is likely to suspend, the repayment of deposits, and its liabilities exceed its assets) (“3-go sochi”).
Further, to cope with the risk of causing a significant disruption to the financial market or system in Japan, the Prime Minister may authorise DICJ to:
(i) supervise the bank, and provide loans or guarantees, or subscribe for shares or subordinated loans to the bank (in case the bank’s assets exceed its liabilities); or
(ii) supervise the bank and provide financial aid necessary to facilitate a merger, business transfer, corporate split or other reorganisation (in case the bank’s liabilities exceed, or are likely to exceed, its assets, or it has suspended, or is likely to suspend, payments on its obligations) (“Tokutei 2-go sochi”).

23. How are client’s assets and cash deposits protected?

Japanese banks mandatorily participate in the deposit insurance system operated by DICJ pursuant to the Deposit Insurance Act, under which the maximum amount of protection is 10 million yen per customer of one bank. This maximum does not apply to non-interest-bearing deposits repayable on demand and mainly used for payment purposes, which are protected without any maximum. Note that deposits not denominated in Japanese yen, negotiable certificates of deposit, and deposits with foreign banks’ branches in Japan are not protected under the deposit insurance system.

24. Does your jurisdiction know a bail-in tool in bank resolution and which liabilities are covered?

Japan has adopted the contractual bail-in approach in its capital adequacy regulation, which requires that the terms and conditions of Additional Tier 1 Capital instruments and Tier 2 Capital instruments of Japanese banks must incorporate a provision writing off the principal or converting the instruments to common equities when public finance aid is necessary to maintain bank operations. The FAQ published by the FSA states that

the necessity for public finance aid is confirmed when 2-go sochi, 3-go sochi or Tokutei 2-go sochi are authorised pursuant to the Deposit Insurance Act (see No. 22). If the Prime Minister triggers the write-off or conversion provision pursuant to the Deposit Insurance Act in such authorisation, these capital instruments will be written off or converted to common equities by operation of the terms and conditions of those instruments.

25. Is there a requirement for banks to hold gone concern capital ("TLAC")?

A TLAC requirement is expected to be implemented in accordance with the TLAC standard issued by the FSB. The standard requires a G-SIB to hold TLAC in an amount of not less than 16% of its risk-weighted assets and 6% of the leverage ratio denominator by 2019, and not less than 18% of its risk-weighted assets and 6.75% of the leverage ratio denominator by 2022.

The FSA released the draft TLAC rule to the public for comment in December 2018 and plans to implement the TLAC rule in March 2019. Furthermore, the TLAC ratios for 2022 will be applicable in Japan from March 2022.

26. In your view, what are the recent trends in bank regulation in your jurisdiction?

The FSA is reforming its supervisory and monitoring approaches from a rule-based approach, which was formed after the financial crisis of the 1990s, to a principle-based, forward-looking approach more suitable for the recent environment of Japanese banks. The FSA changed certain organisational structures in 2018 and plans to abandon the FSA's rule-based Inspection Manuals to suit the new approach.

In June 2018, a study group in the FSA published an interim report, which proposes to reform the fundamental financial regulatory framework from the current industry-by-industry approach (e.g., banks, broker-dealers, fund transfer service providers and

money lending business providers) to a functional or service-by-service approach (e.g., lending, deposit taking, securities businesses and fund transfers) to further facilitate FinTech innovations. This overhaul of Japanese financial regulations is subject to further discussion, but is expected to accelerate the unbundling and re-bundling of financial services, leading the banking industry to an entirely new world.

27. What do you believe to be the biggest threat to the success of the financial sector in your jurisdiction?

The FSA has been keeping a close eye on the sustainability of the current business model of financial institutions, especially regional banks, given the aging and decreasing Japanese population, low and flat yield curves, and technological innovations and digitalisation. Financial institutions are urged to adjust their business models to the new environment, although there are no obvious issues regarding prudence in the financial sector as a whole at this time.